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THE FIRST ANNUAL REPORT OF THE COMPETITIVENESS POLICY COUNCIL

JOINT HEARING

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

AND THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

ONE HUNDRED SECOND CONGRESS

SECOND SESSION

MARCH 4, 1992

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WEDNESDAY, MARCH 4, 1992

THE FIRST ANNUAL REPORT OF THE COMPETITIVENESS POLICY COUNCIL

WEDNESDAY, MARCH 4, 1992

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON TECHNOLOGY AND NATIONAL SECURITY,
JOINT ECONOMIC COMMITTEE, AND
SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS,
Washington, DC.

The Committees met, pursuant to notice, at 9:30 a.m., in room SD–538, Dirksen Senate Office Building, Honorable Jeff Bingaman (chairman of the Subcomitte on Technology and National Security) presiding.

Present: Senators Bingaman, Riegle, D'Amato, Dixon, Dodd, Domenici, Garn, Graham, Sanford, Sarbanes, Sasser, and Specter; and Representative Fish.

Also present: Dorothy Robyn and Ken Jarboe, professional staff members.

OPENING STATEMENT OF SENATOR BINGAMAN, CHAIRMAN

SENATOR BINGAMAN. This is a joint hearing of the Joint Economic Committee and the Senate Banking Committee. The purpose is to examine the first annual report of the Competitiveness Policy Council. This Council is a bipartisan national commission. It was created in the Omnibus Trade and Competitiveness Act of 1988. It was formed in 1991 and charged with analyzing U.S. competitiveness and reporting annually to the President and to the Congress.

I've followed its deliberations with great interest. I, along with many others in the Senate, worked hard to get this included in the trade bill, and we think it's an important initiative for the country's long-term future.

Before I introduce the four Council members who will testify, and defer to Senator Riegle for his opening statements, let me make three very brief points.

First, I hope the report will put to rest once and for all the naive but persistent claim that the United States does not have a competitiveness problem. I quote from the Council's press release of March 1. It says:

"The Council bases its proposals on a unanimous conclusion that America's economic competitiveness is eroding slowly but steadily."

The Council cites various indicators for that slippage, including miniscule productivity growth, declining real wages, and persistent trade deficits.

For the benefit of the editorial writers of the *Wall Street Journal*, let me just reiterate the point with one other quote from the Council's report. On page 10, it says, "We believe that the erosion of competitiveness is a serious problem for this nation, one of the most severe that it faces as it prepares to enter the 21st century."

The second point I wanted to make is that the report confirms my own view that manufacturing is the Achilles heel of American industry. The report notes how, and this is a quotation from the report:

> The United States has substantially devalued the importance of excelling at the manufacturing process with the result that firms in other countries have frequently suceeded at commercializing technologies invented in the United States.

Although the Council faults both industry and government for this devaluation in manufacturing, let me underscore the contributory role of our own obsolete federal technology policy, which, according to the Council, clings to its traditional focus of scientific breakthrough rather than emphasizing commercial follow-through.

Finally, I want to highlight the reference in the Council's report to a manufacturing extension program that is based on the model of the Agricultural Extension Service that we've had for a long time, as a way to promote manufacturing excellence.

Last year, I succeeded in getting the Congress to authorize a national manufacturing extension program to provide matching federal funds on a competitive basis for some of the very good manufacturing centers and extension programs operating at the state level.

Unfortunately, the Appropriations Committees failed to appropriate the $50 million that was authorized for 1992.

I'm going to be working again this year with Senators Nunn, Hollings, Sasser and others to try to ensure that that program is properly funded in 1993.

Before introducing the panel members, let me defer to Senator Riegle, the chairman of the Banking Committee, for his opening statement.

OPENING STATEMENT OF SENATOR RIEGLE

SENATOR RIEGLE. Thank you very much, Senator Bingaman. I want to say at the outset how pleased I am that the Senate Banking Committee, along with the Subcommittee that you run on the Joint Economic Committee, can meet together for this purpose. I also want to salute your leadership, which has been over a long period of time, for bringing these issues into focus and for helping to bring about a national response to these problems.

The Banking Committee, for its part, has major responsibilities with respect to our export and foreign trade promotion, export controls, economic stabilization and defense production. We're also charged under our general charter from the Senate to study and review, on a comprehensive basis, matters relating to the international economic policy as it affects U.S. monetary policy and economic growth.

The issues that are embedded in today's hearing go to the heart of our economic performance and our economic future.

I must say, coming from my home state of Michigan, but looking out across our 50 states, I think that there is a mass of evidence that indicates that we are losing a substantial part of our economic future. And, in fact, the report that's being given to us today by the Competitiveness Policy Council states on its first page this paragraph. It says:

> The average real wage is lower today than 20 years ago. Aggregate productivity has grown by only 1 percent annually for over a decade. We are running the world's largest trade deficits. Much of the economic growth of the 1980s was financed by borrowing from our own future, both at home and from the rest of the world.

Two days ago, I was in my hometown of Flint, Michigan, where we have one of the major plants that will be closed under the announcement that General Motors made within the last two weeks. It is an engine plant in Flint. The average age of the work force there is in the late 40s. The average seniority in the plant now is about 27 years. It's a highly skilled team, like many other manufacturing teams in America. But that plant is closing. That team is about to be shattered and scattered to the four winds.

It is increasingly the story of America—the plant closings and the dismantling of job opportunities. We have 16 million people in the country today unable to find full-time work, but needing full-time work, and in fact, the numbers are rising.

So, there is clearly an underlying, deep, persistent set of economic problems facing America that must be addressed and changed.

We have been holding hearings in this Committee on America's economic performance and competitiveness now for some years.

Back in 1989, in this hearing room, and from that committee table, former Defense Secretary Frank Carlucci told us, and this is his quote:

> You've asked me to identify industries that are in competitive decline. My response is that we are experiencing a competitive decline across the board.

Certainly, he was in a position to make such an assessment—that was from 1989.

Other witnesses that we have had here to testify on these questions include Robert Galvin, the chairman of Motorola; Norm Augenstine, chairman of Martin-Marietta; Don Petersen, the former chairman of the

Ford Motor Company; Felix Rohatyn, senior partner of Lazard, Freres; and John Reed, chairman of Citibank; and we have had many others. I just cite those because those are well-known leaders in their respective fields of work.

Despite the fact that we have had study after study, and massive data accumulated, and committee testimony of the kind that I've just cited, America, for the most part, has continued to drift along. We have not had a coordinated strategy as an American system—a "Team America" strategy where business, government, labor and citizens would have a way to integrate into a forceful plan that could restore higher productivity growth and put us on a very strong economic growth path into the future.

It is my hope that the Council's first annual report, which we will be hearing today, will help us put in place a new and stronger foundation of information and a sense of urgency so that we can actually put the policy building blocks in place that can take us out into a stronger economic future.

I was struck, I might say, also by a story on NBC news this morning that has to do with violence in schools in the City of New York. This is not an uncommon problem, in terms of it being only in a few cities. It's certainly true in cities in my state and across the country.

But in interviewing the people involved and the fact that there is this growing problem of violence and disaffection and disconnection from the society and paths of advancement in ones life, there is an increasing kind of social breakdown that's occurring in America. That's one manifestation of it when students are carrying guns and shooting one another—fatal shootings. But there are any number of other manifestations of what happens to a society when its economy isn't performing properly, and where there is a growing sense of disconnection between critical parts of it.

That's not the principal focus of our discussion today, to get at the issue of how our economy can be re-engineered to perform more strongly, as it must. But the fact is that there's a social consequence and disorder that comes out of economic difficulty. One follows the other. And we're not going to be able to deal, I think, effectively with a rising level of social difficulty if we don't address, in a fundamental way, our economic problems.

We certainly have done it in wartime. We have done it in targeted areas of national endeavor, like the space program, where we set out to go to the moon and were able to amass remarkable technical and production achievements. We have done it in other areas where we focused our attention. We have nearly 30,000 nuclear warheads today that we dare not use, which are as technically sophisticated as the human mind can devise.

So, answers are not beyond us. We can find answers. We have to decide that it's important enough to do that. We have not yet made that kind of an overarching national commitment, and we need to do so. Today, I think we'll have some suggestions given to us as to how we can think our way to those kinds of solutions and put them into effect.

Thank you, Mr. Chairman.

SENATOR BINGAMAN. Thank you very much. Senator Garn, who's the ranking member here on the Banking Committee, please proceed.

OPENING STATEMENT OF SENATOR GARN

SENATOR GARN. Thank you, Mr. Chairman.

I'd like to welcome our panel today to discuss their proposal for building a competitive America. The Competitiveness Policy Council has documented what at least to me and some others is now a familiar list of problems that are limiting America's ability to compete: Short-term thinking by corporate America; disincentives to savings and investment in the tax code; poor results in our educational system; general subordination of competitiveness concerns to other national objectives; and a flawed political process that favors spending and tax cuts over sound economic policy.

The problem is obviously not producing a laundry list of problems. We don't have much difficulty agreeing that at least there is a long list of things that need doing, because every competitiveness report I have seen—and there certainly have been plenty of them over the years—starts off with cutting the budget deficit, providing incentives for saving and investment, and promoting exports.

I don't mean in any way to demean your work, gentlemen. It's a fine piece of work. But I don't know that we needed another Council to give us another laundry list. At least in the 17 years that I've been in the Senate, we've seen many of these.

The problem is that we see the problems, but we don't do anything about them. We all agree that the budget must be reduced, but we simply don't do it.

The first year that I was in the Senate the total budget to run this country was about $300 billion. That was just 17 years ago. Now, the deficit is $100 billion more than we ran the entire country on and defended it with when I became a senator. The interest on the national debt is now larger than Gerald Ford's last budget. Just 30 years ago, John Kennedy ran this entire country for $100 billion, and 48 percent of that $100 billion—$106 billion, I remember—was for defense. Just 30 years ago.

So we talk about it, but we don't do anything about it. When I say "we," I mean Congress won't do anything about it. Those are just facts.

We don't produce any agreement on a bipartisan basis. We refuse to cooperate with the President. It doesn't matter whether it's this President or any other president that I've served with. Even when we had a

President. We had an opportunity to create the framework for an internationally competitive banking system last year, and not due to the lack of effort by the chairman of the Banking Committee, but we produced no reform whatsoever.

There's been a broad effort to produce antitrust and liability reform, but nothing happens in that area.

This report suggests that the way to address our policy failures is to introduce a more conscious competitiveness analysis into the policy process. Measure economic performance against industry benchmarks and judge all policies through the lens of a competitiveness impact analysis.

Well, these efforts certainly can be helpful, but talk and analysis are no substitute for simply doing the things that we know need to be done. And I don't know how to accomplish that, gentlemen. I think we all know what needs to be done. I don't know how to get Congress and an Administration, regardless of whether it's Democrat, or Republican, or whoever runs the Congress, to do something about it.

We know the problem. You don't have to be too bright to figure it out.

I wish somebody could tell us how we could get Congress and the President to work together and put aside partisan differences. There will always be partisan politics in Congress. There has been since the first congress, and I understand that. But I think it's reached a new peak of ridiculousness where both sides are far more intent on political gain and who's going to win the November election than addressing ourselves to this.

That is certainly true of the tax code. I got a standing ovation last week in Utah where somebody asked me what's the best single thing we could do for the economy this year? And I said, not facetiously, have Congress adjourn for the rest of the year. Just go away. Don't do anything. And most of the economists would agree that from the President's plan across the board, most of the tax plans we're talking about have nothing to do with pulling us out of this recession, and certainly not by November. They're so short-sighted that they'll probably do more harm than good.

So, I wasn't being entirely facetious. Unless we're willing to look at long term, what is the impact of our actions on the tax code 3, 4, 5 or 10 years down the road, we're looking at short-term fixes for the election. And I sincerely believe that both sides of the aisle are. We'd be better off to do nothing this year.

So I don't know. I appreciate your work. I just don't know what good panels do any more when Congress and presidents aren't willing to do anything about them.

But I do appreciate your efforts and your work, and it's good, sound analysis.

Thank you, Mr. Chairman.

SENATOR BINGAMAN. Thank you very much. On that positive note—

[Laughter.]

SENATOR BINGAMAN. —we'll go ahead with our distinguished witnesses.

SENATOR GARN. The truth is always tough, Mr. Chairman.

SENATOR BINGAMAN. All right. Let me start by introducing the Chairman of the Council, Fred Bergsten, who is also director of the Institute for International Economics, which he founded in 1981. He was assistant secretary of the Treasury for International Affairs during the Carter Administration. He's written numerous books on international economic issues.

Let me also introduce the other three panelists, if I could, at this time, then I'll defer to Mr. Bergsten to make any other introductions that he thinks are appropriate.

With him are Rand Araskog, who has been the chairman, president and CEO of ITT Corporation since 1980. He's the director of several corporations—the New York Stock Exchange and the Federal Reserve Bank of New York. Mr. Araskog spent five years at the Department of Defense in the late 1950s.

Edward V. Regan is the New York State Comptroller, which is an elected position. He has held that since 1978. In that capacity, he oversees state pension funds worth more than $50 billion. It's Mr. "Ree-gan" instead of "Ray-gan," excuse me.

Mr. Regan was a member of the President's Commission on Industrial Competitiveness from 1983 through 1985.

Finally, Albert Shanker, who is the president of the American Federation of Teachers. He was elected to that post in 1974 and has held that position since. Mr. Shanker is also a vice president and executive Council member of the AFL-CIO. He has a syndicated column entitled, "Where We Stand," that appears in numerous newspapers and has done so for about 21 years now.

I've had the good fortune to serve on a commission on Educational Standards and Assessment recently with Mr. Shanker and note his tremendous contribution to that effort.

Mr. Bergsten, why don't you go ahead?

STATEMENT OF C. FRED BERGSTEN, CHAIRMAN, COMPETITIVENESS POLICY COUNCIL, AND DIRECTOR, INSTITUTE FOR INTERNATIONAL ECONOMICS, WASHINGTON, D.C.

MR. BERGSTEN. Mr. Chairman, let me start on behalf of all the members of our commission by thanking you personally and the Congress more broadly for creating this Council.

You designed a process that is unique and, at least so far, has worked extremely well. You created a quadripartite council in this case, a unique blend of members from the corporate sector, labor unions, government officials—both federal and state—and representatives from the public interest.

What we have decided to do this morning is to have one representative of each of those four groups testify in these opening statements. We do, as you indicated, have a couple of our other members here—John Barry, who is the president of the International Brotherhood of Electrical Workers, also in our labor group, as is Lynn Williams, the president of the United Steelworkers, who very much wanted to be here this morning, but had a commitment he just could not get out of. He's been very active in our work.

Another member of our group, who is with us, is Bruce Scott from the Harvard Business School, who, as you know particularly well, Mr. Chairman, was an active participant in our work, and was active in developing some of the ideas that created this Council back in the Trade Act. Bruce, I can assure you, has been a major contributor and active participant in everything we have done.

SENATOR BINGAMAN. Let me just interrupt for the purpose of suggesting that, I think, Bruce was also one of the key people who continued to emphasize the importance of having this type of Council when we were considering proposing it.

So go right ahead.

MR. BERGSTEN. We're all indebted to him, as well as you, Mr. Chairman, for launching the enterprise.

As I said, it's a unique enterprise. It has the four sectors involved. It's the only commission of this type, I think, that has included both public- and private-sector people working actively together.

It's totally bipartisan. Half the group was designated from one political part of the spectrum. The other half from another. We were appointed from three different points of departure—the President, the Senate and the House of Representatives.

Incidentally, we met yesterday with Clayton Yeutter in the White House to officially and formally present the report to the President. We spent a session also with House Speaker Foley, with the formal presentation on the House side as well. We were about that business yesterday.

I want to start by indicating that, despite this unique structure with people from all sectors and totally bipartisan, we came to a totally unanimous report. There are no dissenting statements. There are no caveats. There are no hedges in this report. And as Chairman, I will tell you that we did not pull our punches in order to reach a consensus.

We did so, I might add, right on schedule as well, meeting the due date that you set for us in the legislation.

The group unanimously concluded, as you already excerpted in your remarks, Mr. Chairman, that the United States has a very serious competitiveness problem. We say that after assessing the whole range of evidence.

There is some good news, and we allude to that and indicate some of it in our report. Certainly, the country is not all in a negative position.

But we concluded that, both relative to the past performance of the United States itself and to other nations around the world, the country clearly has an important competitiveness problem. It's a major challenge. It's a challenge that if our country does not address urgently and extensively, it will be to all of our perils.

We do not just focus on the trade side. We regard trade as an important indicator of the problem and we certainly have strong words to say about improving our trade performance and our export competitiveness, in particular.

But the problem goes well beyond that. The decline in average real wages in this country over the last 20 years, which we show in Figure 1, the slow productivity growth, the huge debt build-up that Figure 13 shows, an enormous explosion of both public and private debt in the 1980s to levels higher than the country ever saw before, even in financing the Second World War, and the lagging education results of our population across the board and now over an extended period.

The group came to the view that this is not a crisis in the normal sense of a Sputnik or a Pearl Harbor, but rather that it is a steady and slow erosion of the country's performance. And indeed, in a democratic system like ours, and perhaps particularly like ours, that makes it very hard to come to grips with.

I think what Senator Garn was indicating—and our commission fully shares—is the difficulty, seeming impossibility to date, of the political process coming to grips with the problem.

We have the sense—and I think Ned Regan will talk about this a little more as a practicing politician—that the public is, in fact, asking for action, is ready for action, but the leadership is not there. And so our effort is to put a program before you that can do it.

As we assess it, the difficulties date back at least 20 years. We say explicitly in the report that there's plenty of blame to go around in terms of the different branches of government, the different political parties, and the different sectors of the economy.

It's a long-term problem. It's an erosion. And the operative question, of course, is what to do about it.

We came to another unanimous conclusion at that point, which is to suggest that the United States must put in place what we call a comprehensive competitiveness strategy, with fundamental reforms in a wide number of areas which underlie the competitiveness problem.

We focused in our initial report on six of those areas. First is the need to increase the terribly low U.S. saving and investment rates. One of our charts reiterates the well-known fact that the United States invests much less as a share of our economy than any other important country in the world. We save less. Those numbers have gotten worse, not better, over the last 10 to 15 years.

That's the physical capital side of things, including, of course, public infrastructure on which investment has particularly declined over the last 20 years.

We talk about human capital—the education and training of our work force. We talk about technology, particularly its commercialization. We make the point that the United States still seems to be good at beginning the process of invention, but not very good at finishing the process—commercializing and turning the inventions and innovations into effective economic products.

We talk about high health-care costs, which are rising to a level double that of the average of the other industrial nations, taking resources away from other potential uses, which we believe would contribute more to our society, without providing a better level of health care for the nation as a whole.

We talk about corporate governance and financial markets, the way that our industry runs itself, and the incentives that our economic structure, particularly our financial markets, provide, or, as we would argue, disprovide, to do that in the right way.

And of course, we talk about trade policy.

When we call for a comprehensive competitiveness strategy, we talk about three components—broad economic policies like saving and investment, and structural policies like dealing with education, health-care costs and technology, and sector-specific policies.

We make the point in the report that the United States, like every country, has sector-specific policies that it's developing all the time. When the President decides in a few weeks on whether to extend the steel quotas for imports, that's an industrial policy. When there was recently an extension of the import quotas for machine tools, that's an industrial policy.

When the President went to Japan and promoted an expansion of our sales of automobiles and auto parts, that's an industrial policy. So, the United States does it like every other country does it.

What we concluded is that it is too frequently done unsystematically, incoherently, and not very effectively. We note that in the past, and you made this point, Senator Riegle, the United States has done thoughtful policies addressed to promote specific sectors. Under the rubric of defense, we've developed a commercial aircraft industry and a computer industry second to none. We've had agricultural sector support from our government for well over a century with enormous success.

And so the issue is not really whether the country has policies addressed to sectors, but whether it does it in a thoughtful, constructive and creative way, as we've demonstrated in the past that we could do.

We feel that that's an element of a comprehensive strategy that is needed.

We also feel, and we make one other specific recommendation, that the competitiveness impact statements which the Congress mandated in the 1988 Trade and Competitiveness Act, but which have not been implemented, need to be implemented for exactly the reasons Senator Garn said. We believe that when the Administration submits legislation to the Congress, and when the Congress considers legislation, it must take into account the impact that it's going to have on the competitiveness of the United States.

We don't like paperwork any more than anybody else does. But we feel that it is essential at this point to have an indication with each piece of legislation that you consider and vote on as to what its impact is going to be on the country's competitiveness. Too often, those considerations are either undervalued or even ignored. We give chapter and verse of that in our report.

Beyond these specific recommendations, we decided not to make detailed proposals at this point in the individual sectors that we had addressed. The reason, as you know better than we, is that this is an election year in which politics are particularly acute. Fundamental reform decisions and actions are not likely to be taken in 1992, and we concluded, therefore, that our best contribution could be to try to highlight the issues, suggest illustrative possibilities for reform in each of these areas, and try to inject those considerations into the political discourse.

As we say in our report, we hope that the candidates will be forced to address these issues, not only the candidates for president, but the candidates for the Senate and the House, that all will be forced to address these issues so that we can have a national debate on these central topics.

What we believe is that in 1993, with a new administration, with a new congress, we can have fundamental reform efforts. We know that it is in the first year of administrations, including re-elected administrations, that reforms of this type can frequently be engineered.

And so what we promise is to come in with our next report—next December or January—with a fully detailed blueprint, trying to suggest what can be done in each of these areas that we focused on.

To enable us to do that, we have picked up on another of the institutional innovations that you in the Congress bequeathed to us in this legislation.

Your legislation called on us to set up subcouncils of our full Council to deal with individual policy issues, with the same quadripartite structure, with business, labor, government and public interest leadership, and to provide a national forum to deal with these issues.

In our report today, we are announcing the creation of eight subcouncils to deal with each of these sectors. The subcouncils are at different stages of preparation, but we are going to have outstanding American leaders participate and leading each of them:

Lynn Williams from the steelworkers will be in charge of the subcouncil on training.

Al Shanker is in charge of the subcouncil on education.

Jack Murphy, the CEO of Dresser Industries, who is also on our Council, couldn't be here today because he's in Australia, is chairing the subcouncil on trade policy.

Ned Regan is chairing the subcouncil on corporate governance and financial markets. He'll talk about that in a minute.

Peter G. Peterson, the former Secretary of Commerce and now head of the Blackstone Group, one of the country's leading experts on the budget and the saving problem, will be chairing our subcouncil on capital formation.

The trade subcouncil that Jack Murphy is chairing, will include Senator Rockefeller, Senator Danforth and Congressman Houghton, as well as two of the top trade negotiators in the current Administration. These groups are going to bring together, we feel, the top leaders in our country to try to come to grips with the problems.

We have asked them to report back to our full Council by November 15. We will then factor them into our overall work, and when we present you with our next report in December or January, we pledge to lay out a detailed set of proposals in these areas.

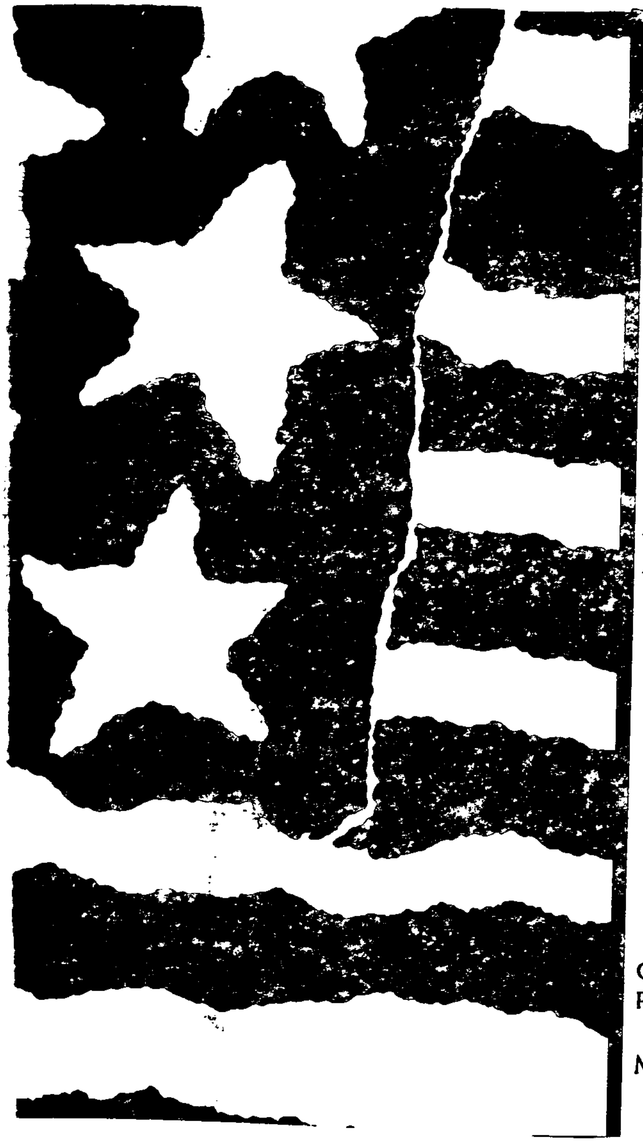
In our present report, we lay out a number of illustrative ideas: Reordering the tax system so that it will shift the incentives away from consumption and debt to saving and investment; to change the education system, and Al Shanker will talk about that, to bring incentives to the students to do better, work harder and provide a more effective work force; and changes in the technology area so that the government can make a much more concerted and effective contribution to the commercialization of technology and to revalue the role of manufacturing, not devalue it as has been done in the past.

So, what we give you today is our initial effort. We come to some pretty strong unanimous conclusions on the severity and nature of the problem. We lay out some broad-based suggestions for how to start going about them. We set up a process that will work in detail on a blueprint that we pledge to present to you in our next report at the end of this year, certainly in time for the next Congress and the new Administration when they convene in early 1993.

We thank you for this opportunity. The process you have designed, as I said at the outset, has to date, worked very well. We've brought our four different sectors together. We've had some sharp disagreements. We've had some sharp debate in the group. It's been healthy. And out of it has come a consensus report that we commend to you now with pride.

I'll turn to my colleagues, I think Rand Araskog first, to add a few words on each of their perspectives, and then we're delighted to answer your questions.

[The First Annual Report to the President and Congress prepared by the Competitiveness Policy Council follows:]



FIRST ANNUAL REPORT TO THE PRESIDENT & CONGRESS

BUILDING A COMPETITIVE AMERICA

COMPETITIVENESS POLICY COUNCIL

MARCH 1, 1992

Competitiveness Policy Council

Washington, DC

March 1, 1992

Honorable George Bush
President of the United States
The White House
Washington, D.C. 20500

Dear Mr. President:

The Competitiveness Policy Council is pleased to deliver its First Annual Report to the President and the Congress. This Report represents a consensus of the Council's members. We unanimously agree that there is much that should and can be done to build a more competitive America. Our main purpose is to bring consideration of the country's long-term economic problems into the mainstream of public debate and policy action.

In an effort to do so, this Report evaluates the competitive strengths and weaknesses of the US economy, offers a diagnosis of its main problems, and makes several immediate recommendations. It then outlines the Council's extensive work program and process for developing more comprehensive proposals during the coming year, including the creation of Subcouncils—as authorized by our legislation—to develop in-depth analyses of eight priority areas of concern. As with all such reports, every member does not of course necessarily agree with every word that is included in its text.

The Competitiveness Policy Council is a 12-member federal advisory committee. One third of our members were appointed by President Bush, one-third by the Speaker and Minority Leader of the US House of Representatives acting jointly, and one-third by the Majority and Minority Leaders of the US Senate acting jointly. The Omnibus Trade and Competitiveness Act of 1988 (P.L. 100-418), as amended by the Customs and Trade Act of 1990 (P.L. 101-382), created the Council "to develop recommendations for national strategies and on specific policies intended to enhance the productivity and international competitiveness of United States industries."

The Council's membership is quadripartite—divided equally among business, labor, government (federal and state) and the public. The members participate as individuals and do not necessarily represent the views of their respective institutions in the work of the Council. One of our members, Secretary of Commerce Robert A. Mosbacher, resigned from the Council on January 15 (when he left the Government) before the preparation of this Report. A replacement for Secretary Mosbacher on the Council has not yet been named by the President.

Appointment of the membership of the Council was completed in the spring of 1991. Secretary Mosbacher convened its first meeting on June 21, 1991. I was elected Chairman at that time. From September 1991 through February 1992, the Council held all-day sessions on a monthly basis. We have consulted actively with a large number of interested members of both the Administration and Congress throughout this period.

We look forward to discussing the findings and recommendations of this Report widely throughout the United States, as we all seek to build a more competitive nation. We hope that our Report, and our subsequent efforts as outlined in it, will make a useful contribution to this effort.

Sincerely,

C. Fred Bergsten

C. Fred Bergsten
Chairman

Enclosure

NOTE: Identical letters were sent to Dan Quayle, President of the Senate and Thomas S. Foley, Speaker of the House of Representatives.

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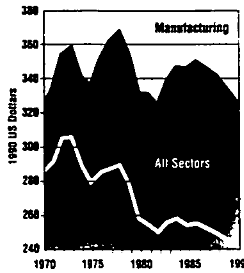
The New Challenge to America

The United States has won the Cold War. Our economy has created forty million new jobs over the past two decades. By most measures, the United States maintains the highest living standards and levels of productivity in the world.

But America's economic competitiveness—defined as our ability to produce goods and services that meet the test of international markets while our citizens earn a standard of living that is both rising and sustainable over the long run—is eroding slowly but steadily. The average real wage is lower today than twenty years ago (Figure 1). Aggregate productivity has grown by only 1 percent annually for over a decade. We are running the world's largest trade deficits. Much of the economic growth of the 1980s was financed by borrowing from our own future, both at home and from the rest of the world.

On present policies and performance, the United States is condemned to slower growth than the other main industrial countries for the foreseeable future. The current recession may turn out to be the longest in the postwar period and is a manifestation of longer term problems that have been building for over two decades. The debt buildup, in both

Figure 1
US Average Real Wages



SOURCE Bureau of Labor Statistics US Department of Labor

public and private sectors, severely limits the scope for effective policy responses.

We live today in a global economy. The share of trade in our gross national product (GNP) has doubled in the last two decades (Figure 2). Our performance relative to other countries, not just relative to that of the United States itself in preceding years, has become a central element of American competitiveness. It is critically important in determining both the level of employment and quality of American jobs.

Hence the deterioration in America's international economic position represents dramatic evidence of our relative competitive decline. Our trade deficits over the last decade totaled $1 trillion (Figure 3). We entered the 1980s as the world's largest creditor nation but exited the decade as the world's largest debtor nation (Figure 4). Per capita income in America has slipped below a number of other countries (see box on page 4). Our national saving rate is now the lowest of virtually any major industrial country and is less than half that of Japan (Figure 14 on page 18). Our investment rate is also less than half that of Japan and below all our other major competitors (Figure 15 on page 19).

In addition, the level of non-defense research in the United States has failed to keep up with other countries (Figure 5). US companies no longer lead in patents granted in the United States itself. Our students rank among the lowest on standardized international tests (Figures 18 and 19 on page 21); only 5 percent of our high school seniors are prepared to do college-level math, according to the National Assessment of Educational Progress. The United States has by far the world's most expensive health care system, adding substantially to the costs of our products, while we are virtually the only industrial country without comprehensive health care for its citizens (Figure 22 on page 24).

Our international slippage is especially dramatic with respect to Japan. With only half as many people as America, Japan has invested more capital in its future productivity than we have—in

What is Competit[illegible]

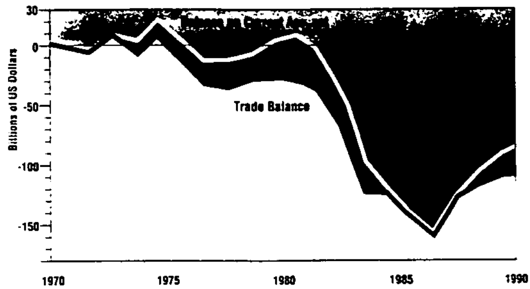
The Council's [illegible] four criteria. First, US goods and services should be of compe[illegible] to those produced abroad. Second, the [illegible] of these goods [illegible] generate sufficient US economic growth to [illegible] Third, investment in the labor and capital [illegible] should be financed through [illegible] over the long run, the nation should [illegible] adequate [illegible] these tests on a continuing basis.

Figure 2
The Increasing Globalization of the US Economy

Year	Trade as a Percent of GNP
1960	10.8
[illegible]	[illegible]
1970	12.7
[illegible]	[illegible]
1980	25.0
[illegible]	[illegible]
1990	24.9

SOURCE US Department of Commerce Bureau of Economic Analysis. Trade includes exports and imports of all goods, services and income flows.

Figure 3
US Trade and Current Account Positions



absolute amounts—for the past three years. It has been spending more, relative to the size of its economy, on civilian research and development. And Japan has overtaken US industry in a number of key sectors.

The Japanese challenge emphasizes a key element of the slippage of American competitiveness: the composition of our economic output. Competitive economies must succeed at the frontiers of manufacturing and technology. Manufacturing generates far higher productivity gains than services. It accounts for almost 80 percent of our international trade. Hence manufacturing is of critical importance to American competitiveness. Yet we have already ceded leadership to other countries in a number of cutting-edge sectors and are now experiencing unprecedented challenges in a wide range of emerging technologies.

Some of this "American decline" reflects a natural catchup by other countries after the devastation they suffered in the Second World War—whether defeated (Japan, Germany, Italy) or victorious (the United Kingdom, France and others). However, as noted already, there are a number of disquieting signs that the United States has experienced deterioration in the performance of its own economy over the past two decades or so. This deterioration, which would be worrisome enough when viewed simply in the domestic context, becomes of even greater concern when compared with the continuing impressive gains of many other nations and America's sharply increased interdependence with the rest of the world. The United States benefits from

Figure 4
Net Foreign Investment Position: Assets Minus Liabilities

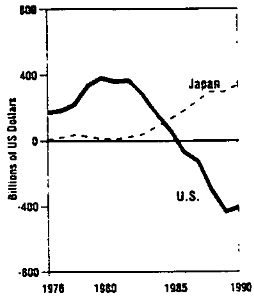


Figure 5
Total Civilian R&D as a Percent of GDP

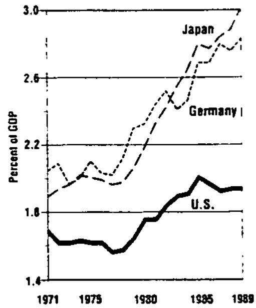
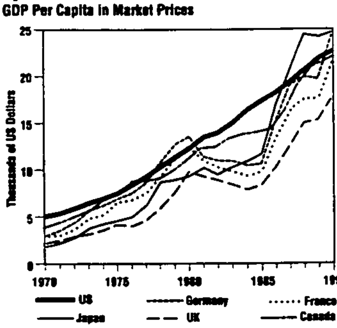
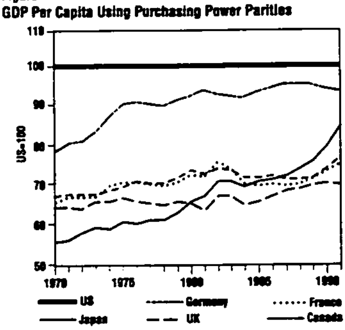


Figure 6
GDP Per Capita in Market Prices



SOURCE: Organization for Economic Cooperation and Development.

Figure 7
GDP Per Capita Using Purchasing Power Parities



SOURCE: Organization for Economic Cooperation and Development.

rapid economic progress abroad as long as its own economy is functioning competitively and as long as international economic arrangements permit it to participate fully in the advances of other countries. If America fails to have its own house in order, or if other countries block its participation, steady improvements elsewhere can hurt rather than help our standard of living.

America's competitiveness problem has an important foreign policy, and even national security, as well as economic, dimension. The United States has been the world's leader in many senses for over half a century: in winning the Second World War and the Cold War, in demonstrating the virtues of democracy and pluralism, in espousing the principles of market economics. Yet the United States will not be able to maintain a leading role, nor perhaps even be in a position to influence world events substantially, if we continue to slide economically. America's future will increasingly depend on our economic prowess rather than our military capability.

To an extent far greater than ever before, foreign policy and national security in the 1990s and beyond will begin at home. The United States will have neither the resources nor the moral authority to be a world leader unless we meet the challenge of improving our competitive position dramatically. The world will be both more dangerous and less prosperous if we fail to do so.

There is plenty of blame to go around, over an extended period of time, for the decline in America's relative competitive position. The issue now is whether the country as a whole can come to understand the fundamental seriousness of the problem, devise remedies that will effectively meet the challenge, and create and sustain a domestic political consensus to do so.

The purpose of the Competitiveness Policy Council, as mandated by the Congress in the Omnibus Trade and Competitiveness Act of 1988, is to help develop an action plan to restore America's competitiveness, and to further popular understanding and greater awareness by our public officials of the problem and what we as a nation can do about it. The Council is a unique body with equal representation from business, government, labor and the public interest. Its twelve members were appointed equally by the President, the bipartisan leadership of the Senate and the bipartisan leadership of the House of Representatives. The Council has been at work since June 1991 and this report represents its first effort to contribute to the national debate.

There have been numerous previous reports on the competitiveness problem and we do not intend to replicate their analyses at great length. Indeed, we could not hope to have devised a comprehensive strategy on such a complex topic in such a short period. In this first

problem
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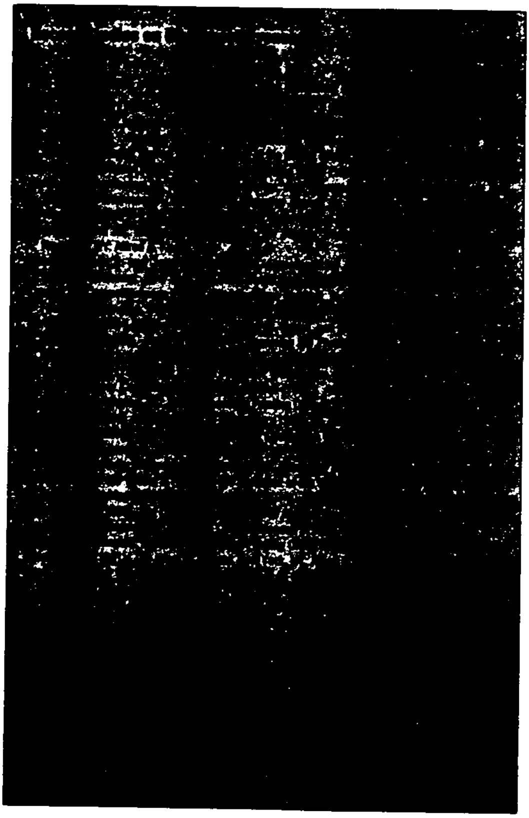
annual report, we therefore intend to do six things:

- highlight the seriousness of the issue;
- analyze the central underlying causes of America's competitiveness problems;
- outline possible courses of action for addressing these causes, without firm recommendation at this point, in an effort to stimulate national debate;
- emphasize that measures put forward to deal with the present economic slowdown will be far more effective if they are part of a program to address the fundamental problems of the economy;
- make specific proposals for enhancing the importance of competitiveness in the hierarchy of national policy concerns; and
- launch a process, including the creation of Subcouncils as authorized by our legislation, to probe deeply into some of the most critical aspects of the competitiveness problem. These Subcouncils will help the Council devise a comprehensive strategy for submission to the President and Congress by January 1993.

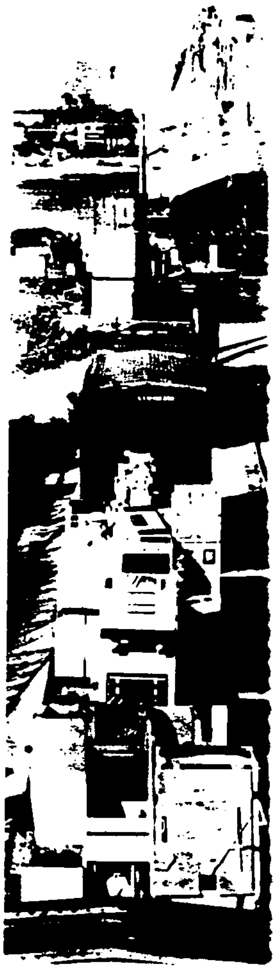


Diagnosing the Problem

America's competitive problem reflects slow erosion rather than sudden crisis. The problem has developed over decades and will take many years to correct. There is no Pearl Harbor or Sputnik to galvanize the nation into action. The Council believes that, in spite of broad public awareness of the nature of the problem, this lack of alarm and drama is a major reason why the United States, as a nation, has not yet developed and launched an effective response.

Pluralistic democratic societies such as ours—and perhaps especially ours—are not adept at responding to "termites in the woodwork." Our national leadership has yet to acknowledge the scope or seriousness of the challenge. The United States has yet to develop a coherent, comprehensive, long-run competitiveness strategy. Our leadership must inspire all Americans to recognize the economic challenge and respond accordingly, mobilizing widespread participation throughout the nation over a sustained period of time.

In addition, some Americans seem to believe that American resources and institutions are inherently the best in the world. This view may have been accurate at one time but is now in doubt in some key areas. Excessive confidence in our competitiveness is another barrier to effective national response that must be overcome.



Action has also proven difficult because of the complex causality that underlies the relative American decline. There is no single source of difficulty nor a single prescribed response. Improving America's competitiveness will require simultaneous changes in a number of areas, six of which our Council has initially identified as most salient: saving and investment, education and training, technology, corporate governance and financial markets, health care costs and trade. Each of these in turn subdivides into a number of important components. (Other factors, such as lagging productivity in the services sector and antitrust policy are also important; the Council plans to address them in the future.)

To add to the complexity, there is clearly a good deal of good news. The growth of productivity in American manufacturing has been substantial in the 1980s—faster than in the 1960s and 1970s, and faster than in most other industrial countries except for Japan (and even there the gap was cut sharply from the previous two decades) (Figure 8). Inflation has declined sharply.

The trade deficit has fallen by about $100 billion from its peak in 1987. The continuing trade improvement provided half of our economic growth in 1990 and halved the severity of the recession in 1991. The United States has regained much of the share of OECD exports of manufactured goods that it lost in the

Figure 8
Manufacturing Productivity Growth: Output Per Hour

Compound Average Annual Growth (in Percent)	1960s	1970s	1980s
[illegible]	[illegible]	[illegible]	[illegible]
France	7	4	3
[illegible]	[illegible]	[illegible]	[illegible]
United Kingdom	4	2	5
[illegible]	[illegible]	[illegible]	[illegible]

SOURCE: Bureau of Labor Statistics, US Department of Labor. Data for Germany begin in 1962

1980s (Figure 9). Many Europeans and others abroad cite fear of American (as well as Japanese) competitiveness as motivation for improving their own performance.

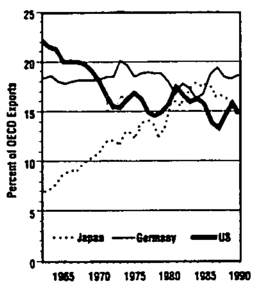
It is clear that a substantial number of American companies, and millions of American workers, have risen to the challenge of the modern world economy. Our aerospace, biotechnology, computer, pharmaceutical, telecommunications equipment and many other industries are leading the world. The Council is encouraged by this progress—achieved mainly by American companies and their workers.

The Council also believes that government has the responsibility to provide a policy environment that supports and promotes a competitive America.

Therefore we are also encouraged that the Federal government has recently instituted several programs that begin to deal with the issues we emphasize in this report. Most state governments have adopted their own industrial programs.

But the United States has to an important extent been living off the vast stock of capital—physical and human—amassed over the second century of its national existence (from roughly the Civil War to the close of the Second World War). Prior to 1940, America's saving and investment rates were among the highest in the world—and considerably higher than Japan's (Figure 10). Our education system was second to none. In the interwar years, American

Figure 9
US Share of OECD Manufacturing Exports



SOURCE: Organization for Economic Cooperation and Development

Figure 10
Historical National Saving Rates

	Percentage of GNP				Ratio to pre WWII	
	Pre-WWII		1950-59	1960-84	1950-59	1960-84
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Australia	12.4	(1861-1938)	26.2	22.7	2.12	1.84
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Japan	11.7	(1887-1936)	30.2	32.5	2.59	2.79
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Germany	20.0	(1851-1928)	26.8	23.7	1.34	1.19
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Norway	11.5	(1865-1934)	27.5	27.1	2.40	2.38
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
United Kingdom	12.3	(1880-1929)	16.2	18.1	1.32	1.47

SOURCE: Bela Balassa and Marcus Noland (1988) *Japan in the World Economy*. Washington, DC: Institute for International Economics.

leadership in manufacturing technology—dominated by the key industries of the day such as steel and automobiles—was clear.

After World War II, however, much of the rest of the world made steady and spectacular progress while the United States improved its position much more slowly. The saving rates of many countries jumped sharply, doubling or more in some cases, while ours remained constant and subsequently fell. Other countries maintained or improved their educational standards while ours slipped badly. Their governments consciously implemented competitiveness strategies, seeking to catch up in manufacturing prowess and technology, while ours focused on other goals.

To an important extent, the United States was the victim of its own success. Our inherently temporary domination of the world economy created a sense of complacency in our companies, our workers and our governments. We ignored the possibility that the normal recovery of the vanquished and devastated could turn—in three or four decades—into a severe competitive challenge for America.

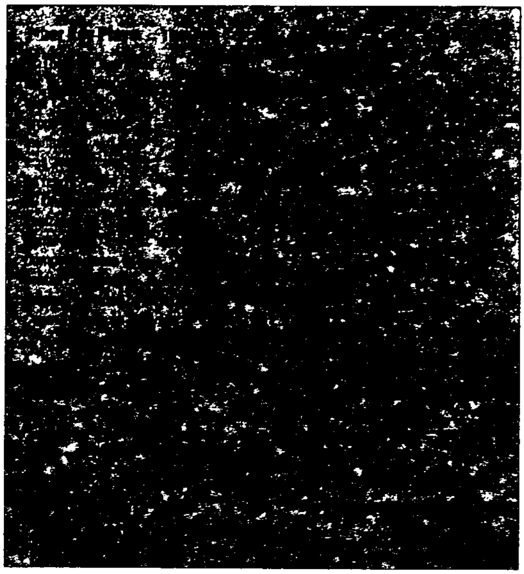
Our Council does not view the elements of good news, and America's stellar record in the past, as justification

...stic democratic ... such as ours— ... erhaps especially ... are not adept ... onding to ... tes in the ... ork."

for any sense of complacency. Rather we believe that the erosion of competitiveness is a serious problem for this nation—one of the most severe that it faces as it prepares to enter the twenty-first century.

But our Council is encouraged by the country's recent progress in several key spheres, the rich heritage of its past, the ability of its people to respond to adversity—especially when inspired by their leaders—its wealth of underlying human and physical resources, and the large number of its private and public institutions that have demonstrated considerable capacity for effective response. We believe these indicators reaffirm the ability of the United States to respond effectively to this newest challenge—though such a response can emerge only when the country develops a plan of action and mobilizes politically to implement that plan. We also note that some of our chief competitors across the Atlantic were recently suffering from so-called "Eurosclerosis" and "Europessimism" but, in less than a decade, have come again to be widely viewed as a dynamic source of world economic growth (despite their current slowdown) and a magnet for international investment.

We also emphasize that relatively modest improvements in performance can have dramatic long-term effects. For example, had we maintained our productivity growth at the 1948-73 average of 2.5 percent annually from 1973 through 1990, instead of letting it drop to 0.8 percent, we would have raised the median family income in 1990 from $35,000 to $47,000—an improvement of over one third. We can eliminate the trade deficit and halt the buildup of our foreign debt by exporting just 1-2 percent more of our annual output.



The Underlying Causes of America's Competitiveness Problem

Many ills exist in America today that, directly and indirectly, adversely affect the nation's competitiveness. But we believe there are three elements—short-termism, perverse incentives and an absence of global thinking—that permeate our society and most directly hurt its competitive position.

Short-termism

The first, and perhaps most fundamental, problem is America's proclivity to think and act with a short-term horizon. By contrast, our competitors around the world plan and execute their actions against far more extended time horizons. These contrasts can be seen at the corporate, individual and governmental levels.

According to a recent survey of over 200 corporate managers by the Time Horizons Project of the Harvard Business School, conducted for the private sector Council on Competitiveness, "US managers believe that their firms have systematically shorter time horizons than do their major competitors in Europe and (especially) Asia"—though these time horizons are longer today than ten years ago. Our capital markets, traditionally viewed as one of America's greatest economic strengths, seem to demand constant attention to quarterly profits. The volatility of our economy, with much sharper fluctuations in both growth and inflation than our main competitors experience, makes it harder to plan for the long run (see box on page 12). Frequent changes in tax, trade and exchange-rate regimes add to this instability.

In addition, a significant number of American companies have failed to recognize the changing nature of the manufacturing process which, if properly addressed, could arm them with greater responsiveness to customers and more financial flexibility. Many American firms do not devote the rigorous attention to manufacturing excellence that is needed to build and maintain market share over time, to bring new products quickly to market and to continuously innovate the improvements needed to meet consumer demand. Product and process innovation, and dynamic responses to market changes, are crucial ingredients for a nation's competitiveness. There is clearly some progress in this area, but many American firms still fail to effectively commercialize new technologies even when those technologies are invented in the United States.

American households also dwell largely in the short run. Their rate of saving is the lowest by far of any major country in the world (Figure 11). The result is far too little seed capital for investment in future growth. The slow growth that results then retards future incomes, both slowing the creation of new jobs and dampening saving (and consumption) still further in the future.

To be sure, far too many Americans live on incomes that are too low to enable

-termism

perverse incentives

absence of global

thinking.

Macroeconomic [illegible] the Time Horizons of US [illegible]

As part of the [illegible] US Competitiveness [illegible] Horizons of [illegible] Lawrence of Harvard [illegible] the extent to [illegible] affect managerial [illegible] work suggests [illegible] US [illegible] and the exchange [illegible] currency is greater than [illegible] Germany or Japan, [illegible] contributes to shortening the [illegible] zons of US managers [illegible]

— US economic growth [illegible] Germany and Japan, leading [illegible] agers to invest [illegible] projects and to be less willing to maintain [illegible] ations in the face [illegible]

— although inflation [illegible] industrialized countries in the 1980s, US [illegible] remained higher [illegible] than in Germany or Japan;

— real long-term [illegible] high in all three countries during the 1980s, but they were [illegible] in the United States; and

— the dollar was [illegible] in trade competitiveness terms during the first half of the 1980s [illegible] more than the DM or yen.

Macroeconomic [illegible] volatility thus clearly play an important role in America's competitiveness [illegible]

them to save at all—especially in the present economic circumstances. Indeed, in a period of declining real incomes many Americans have to draw down their savings, or go even deeper into debt, to maintain their standard of living.

But it is crucial to recognize that increasing the share of saving in national income, which requires reducing the *share* of consumption in the short run, will subsequently lead to a higher *level* of consumption for everyone. Income and hence total consumption are lagging because of the slow growth in total productivity, which in turn is due importantly to the low level of investment and supportive national saving. Increasing the share of saving is thus essential to raise the level of consumption. American households' low propensity to save has the effect of reducing their standard of living and ability to consume over time. Conversely, if they save more as their incomes rise, they will be able to achieve and sustain higher levels of income and consumption in the future.

The Federal government—executive and legislative branches alike—is perhaps most guilty of excessive short-term emphasis. Its huge and persistent budget deficits (Figure 12) exhibit a shocking lack of discipline and concern for the future, creating a massive national debt that must be serviced if not repaid by future generations. That debt is now approaching $4 trillion, or about $50,000 for every American family. Productive private investment is crowded out and huge sums must be borrowed from abroad, adding further to America's status as the world's largest debtor nation.

The emphasis on the present and disregard for the future has been revealed most clearly in the buildup of massive debts over the past decade. In the face of high real interest rates and new tax incentives, which should have induced more saving, every sector in America spent more and promised to pay later. Short-termism reached new heights.

Competitive performance requires that incomes be earned and not borrowed. While borrowing, like foreign direct investment, can be a legitimate source of capital, it must go into investment and not consumption if it is to be a source of future growth. Nations, like individuals, cannot indefinitely borrow for consumption. However, nations can go on borrowing for much longer periods and thus shift the cost of today's consumption onto future generations in ways that most families would reject as unfair to their children and grandchildren.

US competitiveness requires an end to the debt-financed consumption, both public and private, which has characterized the past decade. Aggregate nonfinancial debt, which now stands at about 190 percent of GNP, has soared far above its

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Figure 11
Household Saving Rates

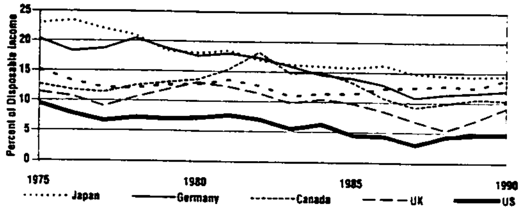
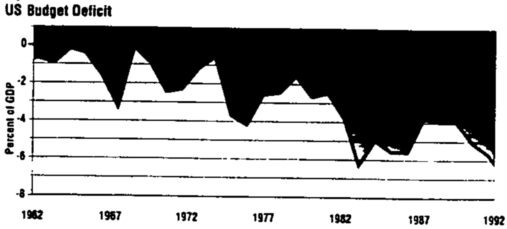


Figure 12
US Budget Deficit



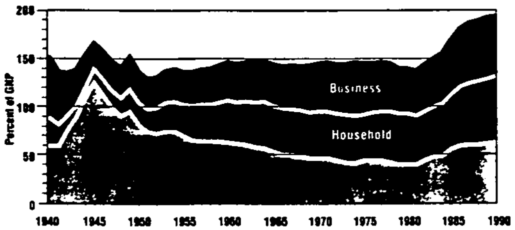
"normal" peacetime range of 135-145 percent of GNP (Figure 13). Our debt has grown much faster over the past decade than it did to finance the Second World War. A return to more normal levels of debt would require substantial changes in the practices of government, business and households.

Perverse Incentives

A second fundamental problem, which helps to explain the emphasis on immediate gratification, is the series of perverse incentives that permeates American society. Our tax laws penalize

...have failed ... rigorous ... to ... facturing ...ence that is ...ded to build and ...tain market ...re over time, to ... new products ...ckly to market and to continuously innovate the improvements needed to meet consumer demand.

Figure 13
Composition of US Debt



SOURCE Federal Reserve Board and Benjamin Friedman

saving, provide little inducement for investment, indeed tilt investment away from productive capital equipment, and favor consumption and debt. Our politicians are rewarded for spending more and cutting taxes rather than for prudent fiscal policies. They can let their successors pay off the tax-free bonds used to finance new projects rather than spend current money on unglamorous infrastructure maintenance.

Similarly, our education system offers few incentives for good performance as many colleges compete for students, whatever their high school records, and potential employers ignore those records as well. Our health care system provides inadequate mechanisms to induce cost containment. There is inadequate linkage between the long-term performance of our corporations and the compensation of their managers or their boards of directors. There are sizable gaps between the incomes of managers and workers.

These perverse incentives have become worse in recent years. The 1981 tax legislation created huge preferences for investment in commercial real estate as opposed to manufacturing. The 1986 tax legislation, while doing away with those particular preferences and eliminating a number of undesirable tax loopholes, also eliminated most of the incentives intended to increase saving and investment that had previously existed in the tax code. (It did eliminate some subsidies to consumption but it left untouched some of the most extensive ones.)

The wave of corporate mergers and acquisitions in the 1980s, many of them hostile, intensified the pressures on corporate America to produce immediate returns to shareholders. Many colleges, responding to the dual pressures of maintaining enrollment in the face of declines in the traditional college-age population and of expanding access to higher education, lowered their standards for admission and retention—thereby reducing incentives for students to take rigorous courses and work hard in secondary school. Health care costs have absorbed rising and unprecedented shares of national output.

Globalization

The third key problem is America's failure to think globally. The share of trade in our economy has doubled in the last twenty years. The United States is now as dependent on trade as is Japan or the European Community as a single entity. One fifth of our corporations' profits derive from their international activities. One in six jobs in manufacturing relies on exports. Almost 25 percent of all agricultural output is sold abroad. Our prosperity depends to a considerable degree on whether we can compete effectively in the world market—including of course within the United States itself against competition from abroad.

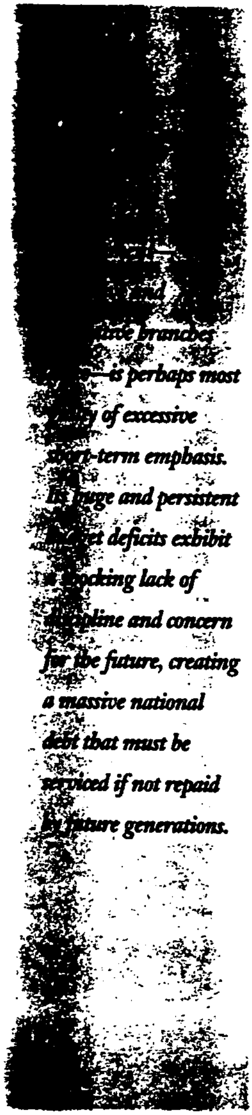
Many American firms are already heavily engaged in international commerce. But only 3 percent are directly active in more than five countries; 15 percent of American firms account for the vast majority of our exports. Much of corporate America, particularly smaller firms for which the costs of entering foreign markets are formidable, has yet to respond to the global nature of today's economy. Even some firms that have internationalized sometimes feel they must take the route of investing abroad rather than competing in foreign markets from their American base, even though the latter would provide greater rewards for the US economy.

The Federal government has frequently ignored the consequences for the American economy of the external effects of its policies. For example, the huge budget deficits and high interest rates of the early 1980s strengthened the exchange rate of the dollar so much that numerous American industries and agriculture were decimated. There have been few efforts to adapt American policy to practices abroad. The United States takes no systematic view of the composition of its economy, except with respect to military production, while many other nations emphasize structure as well as aggregate outcomes.

These tendencies continue to exist to a dismaying degree. Each year's budget debate ignores the continuing and rapid buildup of external debt which increasingly places the fate of our economy in the hands of others. The tax laws of both 1981 and 1986, as noted, ignored their impact on the country's international position. Antitrust policy should consider both global and domestic consequences in determining whether to permit corporate mergers. Myriad policies and practices of our own government block annual exports worth tens of billions of dollars. We have unilaterally disarmed our export credit facilities while the competition expanded theirs.

In the globalized economy of the 1990s and beyond, the United States must consider the impact of all new programs on its competitive position. We cannot ignore the "external" impact of our "internal" actions—indeed the two are now so indistinguishable that the terms lose much of their meaning. American corporations, workers, governments and the public must realize that the competition is global and that American competitiveness can be effectively sustained only if they respond to that reality.

At the international level, the United States has been slow to recognize that the ascendance to global economic power of Europe and Japan will require new forms of collective leadership to maintain a world economy that continues to be both open and globally oriented—rather than divided into restrictive and hostile blocs. The United States has also been slow to seek international harmonization in key policy areas, such as taxation and antitrust, that would limit the damage to the US economy of significant policy differences among the major countries.



Six Priority Issues

The Competitiveness Policy Council identified six specific issues as deserving priority attention in the first stage of its work:

- saving and investment
- education and training
- technology
- corporate governance and financial markets
- health care costs
- trade policy

We do not by any means view this as an exhaustive list of America's competitiveness challenges. Indeed, we plan to address a series of additional issues, such as lagging productivity in the services sector and antitrust policy, in our future work.

In addition, although use of the courts is obviously legitimate and essential to redress individual grievances and to deal with a wide range of issues, especially those relating to safety and health, we believe that excessive litigation is generating sizable costs for the American economy and should be avoided. We also believe, however, that the six issues we have identified are among the most important components of the problem and should be addressed urgently.

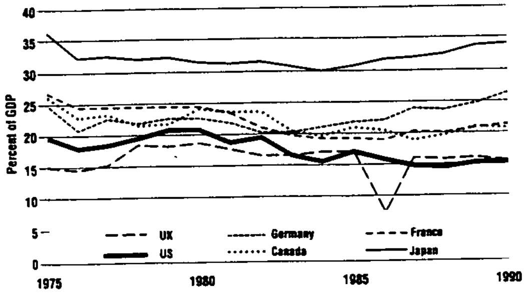
Saving and Investment

America's low levels of saving and investment are clearly a major problem. Competitiveness is largely determined by national productivity. Productivity in turn depends on the stock and growth of physical capital, investment—along with human capital, which relates directly to educational attainment and training, and technology which is driven critically by the ability of a society to innovate and respond dynamically to market opportunities.

Hence national investment is central. In turn, it is ultimately financed by national savings. Capital can be borrowed from abroad but only for a time and only with significant costs. National investment and saving are thus crucial for competitiveness.

The United States has the lowest rates of saving and investment of any industrial country. Our national saving rate is less than half that of Japan and about two thirds that of Germany (Figure 14). Despite a barrage of tax measures in the early 1980s intended to increase both, and broadly favorable economic circumstances, the rate of saving declined further over the past decade and investment failed to rise. Our goal, as in all areas, should be to achieve globally competitive standards for American performance—in this area, raising both the national saving and investment rates substantially by the end of this decade.

Figure 14
National Saving Rates

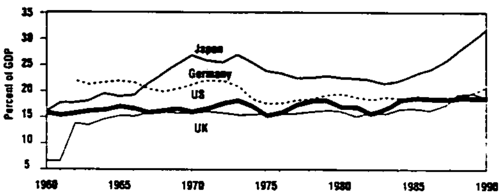


SOURCE: Organization for Economic Cooperation and Development

Two particularly disturbing developments occurred on this front in the 1980s. On the saving side, the national rate had remained roughly constant over the previous century—for as long as statistics on the matter had been compiled. Its composition would change at times but private saving would rise when public saving (the budget position) fell and vice versa. In the 1980s, however, both fell sharply. The result was a further substantial decline in America's already inadequate wherewithal to finance internally even its already inadequate previous level of investment.

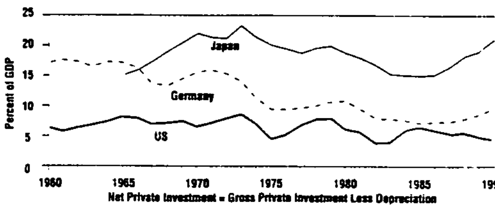
To augment this low rate of national saving, the United States has borrowed massively from the rest of the world—about $1 trillion—over the past ten years. This borrowing converted the country, as already noted, from the world's largest creditor to the world's largest debtor. Such borrowing would have been acceptable, perhaps even desirable, had it been used for new investment to revitalize American plant and competitiveness—as was the case with the country's large importation of capital in the latter part of the nineteenth century. American investment,

Figure 15
Gross Private Investment



SOURCE: DRI/McGraw Hill

Figure 16
Net Private Investment



SOURCE: DRI/McGraw Hill

however, never rose above previous levels (and, on some measures, dropped below them). America's investment rate remains less than half that of Japan and below all other major competitors (Figures 15 and 16).

The foundation of any serious effort by the United States to improve its competitiveness must be a substantial rise in the national levels of investment and saving. Whatever steps are taken to improve our educational system and technological prowess, resources to deploy those gains for lasting economic benefit will be available only if saving and investment rise substantially. The Council thus places the highest priority on these issues.

Both saving and investment can be subdivided into their private and public

... Our goal ... d be to raise both ... ational saving ... vestment rates ... ntially by the ... f this decade.

Private and Public Sa[illegible]

	PRIVATE	PUBLIC
SAVING	Househol[illegible]	Federal budget
	Corporate	State budgets
	Employer-[illegible] pension plans	Local government budgets
INVESTMENT	Commercial [illegible] equipment	Highways, streets and bridges
	Nonresidential [illegible], including industrial, commercial, religious, educational, hospitals and other institutions	Sewer and water systems
		Airports and seaports
		Military facilities
	Public utilities, railroads, telephone and telegraph, electric light and power, gas, petroleum pipelines	Government residential and nonresidential buildings
	Residential housing	

components. Policy measures can be addressed in all four dimensions: tax and other incentives to stimulate private saving and induce private investment, budgetary tightening to reduce public dissaving. Indeed, the Council believes that the Federal budget should be shifted into surplus in order to make a net contribution to national saving.

The Council has devoted particular attention to the fourth area, public investment—the state of the country's public infrastructure (see box on page 22). There is considerable evidence that the sharp decline in attention to our stock of roads, bridges, airports, public buildings and other infrastructure over the past two decades correlates with, and may be an important cause of, the decline in national productivity. We will be working further on the proposition that increased and sustained government spending on infrastructure, primarily at the state and local levels, including through increased Federal funding for their activities, must be an essential part of any comprehensive strategy to restore American competitiveness.

It may prove desirable to clearly distinguish this component of public spending by creating a capital budget for the Federal government. Such budgets have long been maintained by virtually all other countries as well as by state governments in the United States. It will of course be essential to avoid using this device to circumvent budget discipline however, and to avoid the wasteful "pork" that has sometimes characterized public spending programs of this type in the past.

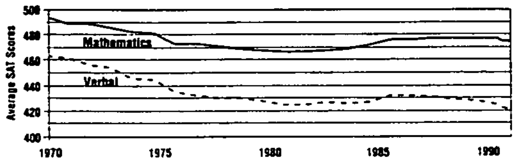
Education

The Council believes that education reform is another critical ingredient of any national competitiveness strategy. A country is only as competitive as its human resources. Japan, Korea and other East Asian countries that have created the most dramatic of the "economic miracles" in the postwar period have done so importantly on the strength of rapid improvement in the education of their workforces.

By contrast, US educational performance—particularly in pre-kindergarten and in K-12—is inadequate by any conceivable standard. Our students' test scores have improved over the last decade but these gains no more than offset the decline of the previous decade (Figure 17). American students rank near the bottom on all recent international comparisons, which include a number of developing countries as well as other industrial nations (Figures 18 and 19). The goal must be a restoration of globally competitive performance by American students by 2000.

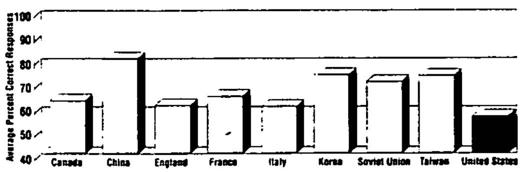
Here too we subdivide the issue into several categories. Primary emphasis

Figure 17
SAT Scores for College-Bound Students



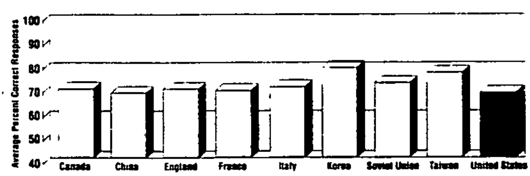
SOURCE: Educational Testing Service. Highest possible score is 800.

Figure 18
Math Proficiency Among 13 Year Olds, 1990-91



SOURCE: Educational Testing Service

Figure 19
Science Proficiency Among 13 Year Olds, 1990-91



SOURCE: Educational Testing Service

...able standard. . . The goal must be a restoration of globally competitive performance by American students by 2000.

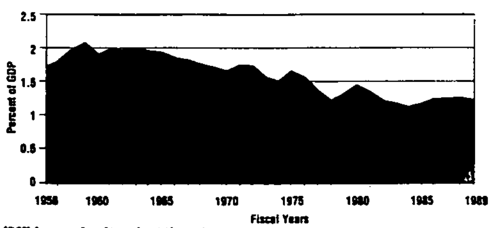
Infrastructure

Figure 20 shows a sharp fall in net public infrastructure investment from a peak of just over 2 percent of GDP in 1959 to a little more than one percent in 1984. There has recently been a modest rebound.

There is some debate as to the contribution of government investment in building and maintaining roads and bridges and other infrastructure to improving the competitiveness of the US economy. Most economists agree that such investment leads to an improvement in productivity although the actual magnitude is in dispute. At one end of the debate, David Aschauer of Bates College (and formerly of the Federal Reserve Bank of Chicago) argues that there is a "virtuous cycle" set in motion by infrastructure spending. Improvements in the infrastructure network raise the productivity of labor and the profitability of private plant and equipment. Higher profitability spurs private investment, which further boosts productivity. In all, Aschauer estimates that every additional dollar of public investment will boost private investment by approximately 45 cents—and that US productivity growth could have been 50 percent higher over the past two decades had we maintained the previous level of investment in public infrastructure.

Others believe that these relationships are not nearly as strong. For instance, Charles Hulten of the University of Maryland and Henry Aaron of the Brookings Institution have obtained lower estimates of the importance of infrastructure spending to economic growth and competitiveness. But Hulten and Aaron also agree that infrastructure investments carry the potential to improve America's economic performance.

Figure 20
Total Government Capital Spending on Infrastructure as a Percent of GDP



SOURCE: Congressional Budget Office and Council of Economic Advisors

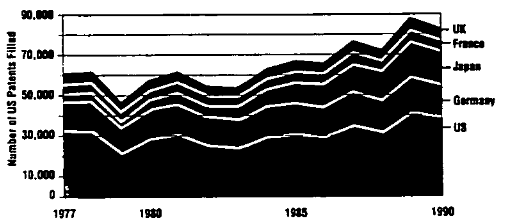
should probably be directed at pre-kindergarten and K-12, where the overwhelming majority of the entire population gets its formal education. It is essential that these reforms focus simultaneously on raising student performance at all levels. Standards of achievement, and the incentives for meeting them, must be raised both for students who plan to go directly to college and those who intend to go directly into the workforce. Another area is also crucial: periodic if not constant retraining of adults, who must shift jobs as a result of the continuing dynamics of the marketplace or upgrade their skills to remain effective in a given job whose requirements are rising steadily due to technological and other changes.

Technology

Technology is the third area to which the Council has attached priority. The problem is not primarily at the level of scientific invention. To be sure, other countries are catching up to the United States on such indicators as patent filings (Figure 21) and Nobel Prize winners. We cannot be complacent on this front any more than on the others, or one key area of continuing American leadership could founder as well.

The main problem at present, however, is in the relatively mundane area of

Figure 21
Composition of US Patent Filings



manufacturing process, where technological innovation is translated into commercial success—the "development" in "research and development." Research, development, design and production, marketing and customer service are essential elements in a competitive manufacturing system. Neglect of any of these elements renders the system less efficient. No scientist, no researcher, and no sales or service facility can operate in an effective manner without communication and cooperation from all elements of the system. Good engineering and design occur when engineering specialists benefit from input from those who implement the science and from those who use the technology.

Moreover, management in many companies has failed to draw effectively on its workforce for ideas on how to improve the manufacturing process. Human resource development through greater cooperation between management and labor can play an important role in restoring the ability of American enterprises to sustain profitability and higher real wages in the global market. Japanese and some European firms, and a growing number of US companies, have demonstrated that synergistic labor-management relations can be an important source of productivity improvement and thus an important ingredient for increased competitiveness.

The United States has substantially devalued the importance of excelling at the manufacturing process with the result that firms in other countries have frequently succeeded at commercializing technologies invented in the United States—much as American firms, during

finishers.

Our goal should be a rate of growth in manufacturing productivity in the 1990s that equals or exceeds Japan's and continues to exceed that of other industrial countries.

the early decades of this century, excelled at commercializing technologies invented in Europe. Americans remain good starters while others have become better finishers.

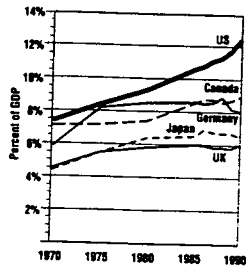
Federal technology policy has contributed to this evolution by clinging to its traditional focus on scientific breakthrough rather than emphasizing commercial followthrough. Another key issue, which is both a cause of the problem and a symptom, is the decline in the number of engineers graduating from American universities to a level below that of Japan on a per capita basis. Our goal should be a rate of growth in manufacturing productivity in the 1990s that equals or exceeds Japan's and continues (as in the 1980s) to exceed that of other industrial countries.

Corporate Governance and Financial Markets

Our fourth priority area is corporate governance. The Council believes that the responsibility for improving American productivity lies primarily with American industry and its workers and that industry's ability to contribute effectively to a competitiveness strategy is thus of utmost importance. A nation's competitiveness ultimately rests on the quality, performance and cost of goods and services produced within its borders. This in turn places heavy emphasis on the nature and performance of the companies there (whatever the mix of domestic and foreign ownership). The environment set for them by government policy is of course critical to these outcomes, in the manners described above and below, but the fundamental achievement of national productivity is largely up to the firms. Thus their modus operandi is of central importance.

One key issue is whether there are elements in the economic and financial environment in which American firms operate that constrain their ability to compete. In particular, as discussed in the previous section, US capital markets can divert the attention of US managers from long-run considerations of maximizing market shares to a short-run focus on quarterly profits. The macroeconomic instability of the United States, with inflation rates both higher and more volatile than in Japan and Germany, seems to have a similar impact. The governance issue also relates importantly to the structure of corporate management: the role of boards of directors, the relationship between them and management, the role of employees in management, the incentive systems on which compensation is based and the like. One national objective should be to create an environment of economic and policy stability within which managers can do what many of them already want to do—manage the corporation for long-term growth.

Figure 22
Health Care Expenditures as a Percent of GDP



SOURCE: Organization for Economic Cooperation and Development

Health Care Costs

Our fifth issue is health care costs. We single out this sector for particular attention because of its enormous and growing impact on the economy and Federal budget, and the marked disparity between this impact in the United States and in other countries (Figure 22). Expenditures for health care have risen from 7-8 percent of US GDP in 1970 to 12-13 percent today and are projected to rise to 15-17 percent, on current policies and practices, by 2000. This would be roughly double the level in all other industrial countries. Moreover, there is widespread awareness that these additional costs are not

Figure 23
Health Indicators, 1989

	Life Expectancy at Birth (years) Male	Life Expectancy at Birth (years) Female	Infant Mortality (per 1 000 live births)	Health Spending as Percent of GDP	Doctors per 10 000 Population
Japan	75.9	81.8	4.6	6.7	16
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
United States	71.5	78.5	9.7	11.8	23
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	14
France	72.4	80.6	7.5	8.7	30
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Holland	73.7	80.0	6.8	8.3	24

SOURCE: Organization for Economic Cooperation and Development *Data for 1985 and 1986

buying better health for the population as a whole. Indeed, while some parts of the population are receiving the best health care in the world, other Americans are receiving care that is inferior to that in many other nations (Figure 23).

The question for our purposes is whether such costs, which divert a large share of national resources that could be used productively elsewhere, are significantly undermining American competitiveness. They can do so in at least two ways:

(1) by raising the total costs to corporations that pay for health care for their workers and retirees (and thus the prices of those companies' products), especially for manufacturing industries where these costs fall particularly heavily, and

(2) by consuming resources that might be otherwise deployed for strengthening the infrastructure, supporting technology development, or improving education.

The national objective should be the achievement of world-class health care for all Americans at a cost to the economy that is comparable to the other major industrial countries.

Trade Policy

Our final priority issue is trade policy. Trade is different from the previous five issues because it relates indirectly rather than directly to productivity and the cost structure of the economy. It can nevertheless be extremely important.

For example, an overvalued exchange rate for the dollar—as occured in 1981–85, creating the massive trade deficits that followed—can price American

[illegible] in goods and [illegible]ces and hence halt the need to borrow abroad with consequent further buildup in the nation's foreign debt.

goods out of the foreign and domestic markets that are crucial to enable them to achieve full economies of scale. An overvalued dollar can also discourage American firms from making a maximum effort to improve their performance by competing aggressively against the world's best. Foreign barriers that block the access of American products to markets abroad, and subsidies and other practices that enable producers abroad to compete unfairly against producers here, likewise jeopardize those two important competitive benefits. Some of the export disincentives and barriers maintained by the US Government itself can have similar effects.

Trade is of course a central focus of the entire competitiveness debate. Some observers in fact view the trade balance as the best single proxy for America's competitive position, or even as essentially defining the problem. The Council rejects that view because it believes that the ultimate test of a nation's competitiveness is the standard of living of its own population, to which external trade is a very important but only one contributing factor. Moreover, macroeconomic problems such as large budget deficits can lead to trade deficits whatever the underlying state of the country's competitiveness.

In today's global economy, however, the trade balance provides an extremely valuable barometer of how a country is doing competitively—and whether it is earning its current standard of living. On these counts, and despite the recovery in our exports over the past five years, the American record of the past decade is dismal. In addition, trade improvement enhances the role of the manufacturing sector because swings in the overall trade balance are dominated by swings in manufactures trade. We should aim by 1995 to eliminate the deficit in our global trade in goods and services (the current account) and hence halt the need to borrow abroad with consequent further buildup in the nation's foreign debt.

This aggregate goal is not intended to imply indifference to what we export. The Council believes it is important that the United States enhance its position as an exporter of products based on high levels of skill and high value added, i.e., manufactures that can support high wages. An alternative approach, which might rely upon a declining exchange rate to stimulate exports, is not what we envision.

Framework for Action

As the Council submits this report in early 1992, concerns over fundamental aspects of the nation's competitiveness fuse with the need for the earliest possible recovery from recession. The positive aspect of this fusion is that the difficulties of the present reinforce awareness of our more basic problems. The risk is that efforts to boost growth in the short term could ignore and even exacerbate the basic difficulties.

The Council believes that the right strategy at present is to devise a program to address the underlying weaknesses in the economy in ways that could also promote short-term recovery. For example, an acceleration of government spending on needed infrastructure projects would have desirable effects both immediately and over time.

But the emphasis must be on righting the basics. Problems with the country's underlying competitiveness have limited our short-term options and will continue to constrain them until fundamental reforms have taken hold. Conversely, the most likely return to prosperity lies in addressing these structural problems and thus restoring confidence in the long-run prospects for America. The Council believes that the time has come to seek far-reaching reforms that would effectively come to grips with the deep, abiding problems identified above.

Our strategy in this report is to identify, and briefly elaborate, reforms in several areas that might generate such improvements over time. The Council is not yet ready to make firm recommendations for such a program but believes that actions of the type described, and the problems they seek to correct, should be focal points of national inquiry and debate during the coming year. Public officials and candidates for all offices should address them. The public, which often exhibits a keen awareness of the problem, should insist that they do so. This is the only process through which fundamental change can emerge.

Toward A National Competitiveness Strategy

In each of the six areas to which we have addressed priority attention, the Council believes that efforts should be made to devise new policies that will make a fundamental change in America's competitive position. In this section, we offer illustrations of the kinds of reforms that we have in mind. The Council is not endorsing any of these steps at this time, having had inadequate time to explore their likely effectiveness and their full ramifications for the country. We believe, however, that these ideas, and others that pursue the same goals, should be seriously considered. The Council itself will be developing and testing such ideas preparatory to issuing firm recommendations in its next report. We urge other interested groups and individuals to do so as well.

In each area, national goals—such as those suggested in our prior discussion of the problems—should be set, against which subsequent performance can be gauged. We want a results-oriented strategy against whose criteria government, business, unions, educational and other institutions can be held accountable. In light of the sweeping scale, novelty and even experimental nature of some of these ideas, constant evaluation of their progress would be needed and should be built into the reforms themselves.

Saving and Investment

The most obvious initiative to enhance saving and investment would be conversion of the budget deficit of the Federal government into balance or preferably surplus. The deficit drains more than half our private saving and drives up interest rates. It pushes us deeper into debt both at home and abroad. It raises serious doubts as to whether the country will ever put its house in order.

A surplus, by contrast, would make a net contribution to national saving. It would also provide a prudent foundation for the increases in pension and medical payments to our older citizens that will become inevitable as the population ages early in the next century. An overall budget surplus would in essence permit the surpluses in the Social Security and other trust funds to become genuine national saving rather than financing the rest of the government budget. It would provide a cushion against future economic difficulties.

Converting the deficit into a surplus will require an intensive review of all major spending programs. If adequate spending cuts cannot be found, it may be necessary at some future point to increase revenues. The sum of these improvements will have to exceed the present deficit because additional spending will be needed on some programs, such as public infrastructure, to promote US competitiveness.

In order to further enhance saving, it might be necessary to change the structure of US tax policy in ways that would eliminate, or even reverse, the perverse incentives in the present code. The most extreme option would be to substitute consumption-based taxes for all or some of our present income-based taxes. The effect would be to exempt all saving from taxation. The result should be a substantial rise in saving that would produce a sharp fall in the cost of capital. A less sweeping way to stimulate private saving would be to exempt all interest and dividend earnings from taxation, as

Japan did until 1988 with its *maruyu* system that enabled each citizen to hold multiple tax-free savings accounts and invest in tax-free bonds.

Saving could also be encouraged indirectly through tax changes that would discourage consumption. Alternatives could include a value-added tax (VAT), as utilized in virtually every other major country; a national sales tax; limitation of the tax preference for interest paid on home mortgages that now applies up to $1 million; or other sector-specific approaches. These could replace some portion of today's income-based taxes or be adopted, instead of other types of taxes, to raise additional revenues as part of the essential effort to curb the budget deficit.

All of these pro-saving tax proposals have some undesirable features. The impact on income distribution of most of them is likely to be regressive. Despite the crucial importance of raising saving for the long run, it would be a mistake to dampen consumption too quickly in light of the present state of the economy.

These risks are genuine but can be countered by careful design of the taxes and by offsetting measures elsewhere. For example, necessities such as food and medicine can be exempted from a VAT or sales tax. Direct rebates can mitigate effects on the poor. If the new taxes were only a partial element in the overall regime, as is likely, the progressivity of the income tax could be increased to maintain fairness in the overall tax system. Some members of the Council nevertheless believe that consumption-based tax measures would be inappropriate and would prefer to continue relying on the progressive income tax.

Education

Sweeping reform of education, which the Council also believes should be seriously considered but on which we are not making specific recommendations in this report, would rest on building new incentives into the system at all levels. Colleges and universities would grant admission into degree programs only to those students who have demonstrated that they are prepared for real college-level work. The Federal government would provide incentives for colleges to raise their standards, and for students to meet those standards, by conditioning its institutional and student aid on this basis—and by making sure that all qualified students, however needy, obtain a college education.

Teachers and other K-12 personnel would be rewarded, as a group at each school, for improved performance by their students in meeting higher standards. Students and parents could be given a choice of schools to attend. Teacher pay would be made sensitive to shortages in individual disciplines to

[illegible] short-term [illegible] and will [illegible] to constrain [illegible] fundamental [illegible] have [illegible] bold. [illegible] likely return [illegible] prosperity lies in addressing the fundamental problems and thus restoring [illegible] in the [illegible] prospects [illegible] America.

stimulate the supply of teachers in those areas. The impact on productivity of our system of educational governance and administration should be examined.

Similarly, students who do not attend college should be qualified to obtain good jobs as they leave high school. Employers would begin to scrutinize high school transcripts and teacher recommendations, and take them seriously into account in their hiring decisions. Companies might earmark some jobs for graduates designated by certain high schools, based in turn on those students' records. Structured work-study programs, drawing on German and other European experiences, could substantially improve both the job prospects for high school students and the quality of the workforce that emerges.

Training

Fundamental reform can also be envisaged for aiding workers who must shift jobs due to dynamic changes in the economy. We now rely essentially on market forces and the efforts of some individual companies—and the latter should be improved and expanded to cover all classes of employees. But our Federal government has never mounted effective or widely accessible training programs. Most other industrial countries do it—and most of them spend more than twice as much as the United States on the effort (Figure 24). The focus of a new training program would be on comprehensive worker adjustment assistance that comprised retraining, job search assistance and temporary income support tailored to the needs of the individual. Achievement of a fully competitive educational system would of course help to alleviate this problem as well.

Technology

On technology, the United States could establish a new mechanism for government and industry to work together to promote the development of generic pre-competitive technologies that are not being financed by the private sector. The Federal government has done a good job in supporting defense-related technologies, through its own national laboratories and the Defense Advanced Research Projects Agency (DARPA), but has been much less effective on the civilian side. There are huge differences between the two, and it is clear that expertise in generating and utilizing defense technologies cannot be easily transferred to commercial products.

Nevertheless, the end of the Cold War frees an enormous amount of high-quality resources in the United States: scientists, technicians, skilled workers and managers as well as capital in both the private and public sectors. An historic opportunity exists to redeploy at least some of those resources into channels that will support the restoration of American competitiveness. Much of this conversion must be accomplished in the private sector and some individual firms have already succeeded in launching the shift.

The Federal government, however, may need to stimulate and encourage the process. In addition to creating a

Figure 24
Training Programs in Selected Industrialized Countries

Country	Participation (Percent of Labor Force)	Average Duration in Months	Total Expenditures (Percent of GDP)	Expenditures per Participant (in US Dollars)	Expenditures per Participant as a Percent of Average Income
Canada	1.1	6	0.22	$7,000	37
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Germany	1.5	8	0.25	$7,200	37
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
United States	1.0	3.5	0.05	$1,000	9

SOURCE: Organization for Economic Cooperation and Development, *Labor Market Policies for the 1990s*, Paris, 1990. Data refer to the period 1988.

new mechanism for government-industry technology cooperation, at least large parts of the national laboratories—among our finest national institutions—should be redirected toward commercial ventures. More effective commercialization of new technologies could be promoted through the creation of new programs and institutions aimed at technology diffusion and application, such as a manufacturing extension program on the model of our agricultural extension service.

Corporate Governance and Financial Markets

On Corporate Governance and Financial Markets, the issue is whether our present system promotes or impedes growth in competitiveness. This question can be answered by careful evaluation of a number of propositions including the following:

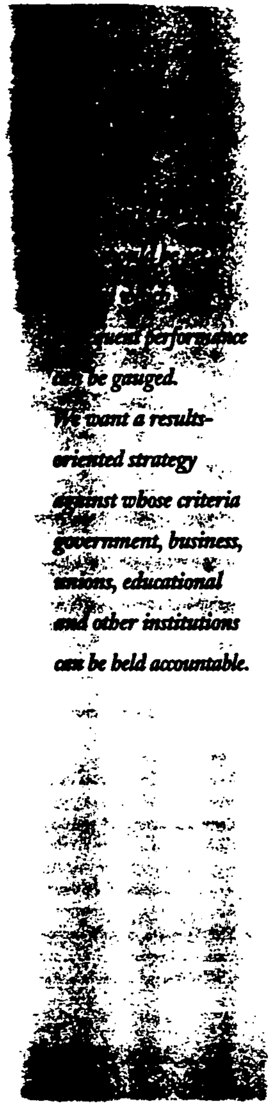
- the degree to which long-term performance is the shared goal of both corporate managers and shareholder-owners;
- the degree of management's accountability to owners;
- the effectiveness of owner monitoring to achieve this goal;
- the impact of the "short term" signals sent by the trading practices of institutional investors and management's reaction to them;
- the desirability of dampening current rapid stock turnover patterns;
- the degree to which management's goals of creating shareholder value, creating corporate wealth and advancing the interests of stakeholders (including workers, suppliers and communities) conflict or harmonize with each other, and the preference for one over the other; and
- the effect of legislation in establishing a duty to these several constituencies.

Health Care Costs

Comprehensive reform of health care, in addition to pursuing universal coverage, would involve a recognition that incentives for efficient utilization of medical care are lacking at all levels of the system. To deal with exploding costs, the Federal government could make use of a variety of containment strategies (including expenditure caps) both to reduce unnecessary use of medical services and to improve efficiency of the health care payment system.

Several alternative possibilities are currently being discussed:

- a single payer at the national or state levels could be established (with new limits on malpractice liability);
- to deal with the problems of the uninsured, about 80 percent of whom are in working families, Congress could mandate employment-based



coverage through a pay-or-play tax as recommended by The US Bipartisan Commission on Comprehensive Health Care (Pepper Commission);

- individuals could receive assistance in buying insurance with vouchers, tax credits or expanded regulations;
- a new universal access system could be created similar to those in other industrial countries.

Trade

On trade, the Council also believes that an extensive set of reforms should be considered:

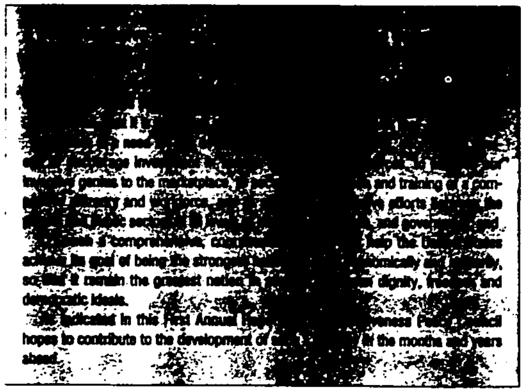
- an agreement among the Group of Seven industrial nations (G-7) to maintain the exchange rate of the dollar (and other currencies) at a competitive level, building on the "reference ranges" that were agreed in 1987. Avoiding dollar overvaluation is of central importance in maintaining American trade competitiveness;
- more broadly, agreements with the other economic superpowers (the European Community and Japan) to coordinate macroeconomic and monetary policies to sustain world growth and thus a hospitable environment for continuing trade expansion;
- effective results that will promote US trade, employment and other interests through the several international negotiations in which the United States is presently engaged: most importantly, the Uruguay Round in the GATT, but also the North American Free Trade Agreement and subsequently the Enterprise for the Americas Initiative;
- substantial expansion of the Export-Import Bank to match both the magnitude and effectiveness of other countries' official export programs, as needed to induce others to agree to limit (or preferably eliminate) intergovernmental competition in this area;
- elimination or sharp reduction of many of the export disincentives (excessive or unnecessary national security controls, foreign policy controls, sanctions, short supply controls, etc.) that now curtail billions of dollars worth of foreign sales by US firms annually;
- evaluation of the effectiveness of US trade laws;
- effective assessment of the practices pursued by our trading partners, specifically with regard to how such practices affect US exports;
- a reduction in staff turnover in the relevant government agencies to improve America's ability to negotiate beneficial trade agreements; and
- comprehensive assessment of how multinational corporations, particularly those headquartered domestically, affect our competitiveness.

Specific Proposals

As noted, the Council is not yet prepared to recommend reforms such as those outlined above pending further analysis and discussion. Before turning to the procedures by which it intends to pursue these and other possibilities, however, there are two specific recommendations that the Council does make at this time.

First, the Council agrees that **the time has come for the United States to establish a serious "competitiveness strategy" through both sector-specific and generic policies.** We note that the United States has in fact carried out strategies toward certain sectors of the economy and key industries from the birth of the republic under different rubrics—including agricultural policy, defense policy and aerospace policy—with the effect of supporting particular sectors deemed essential to the national interest. There have been failures but the results have sometimes been spectacularly successful: the world's most competitive farms and commercial aircraft, a robust computer industry and many more. There need be no embarrassment over conscious endorsement of such a policy, particularly as it is pursued by virtually all other countries around the world.

Moreover, under Administrations of both parties and all ideological orientations, the United States has frequently employed import quotas, tax incentives, government loans and procurement, and numerous other devices to support or protect individual sectors (or even individual firms, as with Chrysler and Lockheed). These approaches, however, have been largely episodic and *ad hoc*. We need to replace this latter approach by the establishment of policies like those mentioned above and with a coherent, consistent and effective "competitiveness strategy."



Our present governmental structure was not designed to help this country compete in a global economy. Its only two high-level economic officials, the Secretary of the Treasury and the Chairman of the Federal Reserve Board, are primarily responsible for financial matters. The government needs to designate an agency, perhaps a substantially strengthened Department of Commerce or the International Trade Commission with its functions greatly expanded, that would raise the nation's awareness of the competitiveness problem and initiate and maintain several activities:

- assessing the likely course of key American industries, including at least some of those on the very similar lists of "critical technologies" drawn up recently by several Federal agencies and other groups in this country and abroad, over the coming decade or so;
- comparing these baseline projections with "visions" of industry paths that would be compatible with a prosperous and competitive American economy;
- monitoring the activities of foreign governments and firms in those same sectors to provide "early warning" of competitive problems that might be on the horizon. The intelligence community might be able to contribute significantly to this part of the effort;
- acting as an ombudsman within the Federal government for specific competitiveness issues that are affected by Federal laws and regulations.

With such an analytical mandate and capability, the United States Government would—for the first time—be in a position to respond intelligently to proposals for assistance from specific industries. It would be able to fashion and pursue a coherent and disciplined competitiveness strategy. Such efforts would of course have to be coordinated closely with macroeconomic and other related policies so the Council of Economic Advisers, the Treasury Department and the USTR would need to be closely involved. But these efforts would add an entirely new dimension to the government's capability to provide a competitive environment for the economy and, at a minimum, to respond adequately to sectoral problems as they inevitably arise.

Critical Te[illegible]

Numerous [illegible] recently listed and analyzed technologies [illegible] The Department of Defense's *Critical Technologies* [illegible] on 20 [illegible] uct technologies [illegible] long-term [illegible] The National Critical Technologies Panel [illegible] and Technology Policy (OSTP) is also required [illegible] March 1991 report focused on [illegible] the "long-term national security and [illegible] have been developed by the [illegible] of Commerce, the Aerospace Industries Association and the private sector [illegible] on Competitiveness.

The March 1991 [illegible] Office of Science and Technology Policy includes one of the most [illegible] critical technologies:

- aeronautics [illegible]
- applied mo[illegible]
- ceramics [illegible]
- composites [illegible]
- computer simula[illegible] modeling
- data storage and [illegible]
- electronic and [illegible]
- energy [illegible]
- flexible computer-[illegible] manufacturing
- high-definition imaging and displays
- high performance computing and networking
- high performance [illegible] and alloys
- intelligent process[illegible] equipment
- material synthesis [illegible] processing
- medical [illegible]
- micro- and [illegible]
- microe[illegible]
- photonic[illegible]
- pollution [illegible]
- [illegible]
- [illegible]
- [illegible]

Second, it is clear that our political institutions should take account of the implications for the country's competitiveness of all new programs that they adopt. The Congress already reached such a judgment in 1988 when, in the Omnibus Trade and Competitiveness Act, it mandated the preparation of Competitiveness Impact Statements for precisely that purpose. The law has seemingly been ignored, however, and such Statements have played no role in the national debate on critical issues including the budget, tax policy, education and health care reform.

We therefore believe that the **Administration should prominently include a Competitiveness Impact Statement with each recommendation or report on legislation that it submits to the Congress. The Congress should insist that such Statements be submitted, review them carefully, and take them fully into account in making its decisions on all relevant legislation.**

Next Steps

In addition to offering these recommendations, the Council is launching an ambitious workplan for the coming year. First, based on this initial report and our continuing work, the Council will from time to time be making recommendations on specific issues that

... or report ... The requirement ... for ... period, of which over ... already elapsed. ... to begin implementing ... law now.

nay arise in legislative or rulemaking roceedings. We regard the Council as a 'competitiveness ombudsman" that will attempt to draw attention to competitiveness concerns in the debate over generic policies, and on issues concerning specific sectors and firms, and invite interested parties to alert us to topics that need to be addressed in that context.

Second, as authorized in the Omnibus Trade and Competitiveness Act of 1988, the Council is establishing a set of Subcouncils to assist us in crafting solutions to a number of the major competitiveness problems facing America. The Subcouncils will seek to develop goals for America in each area and offer specific recommendations to deal with the problems they are addressing. We are directing each Subcouncil to submit its initial set of recommendations to the full Council by November 15, 1992. The Council will review these recommendations and report on them in its next Annual Report to the President and Congress.

Like the Council itself, our Subcouncils comprise a novel structure designed by the Congress to elicit constructive solutions from a quadripartite group of representatives of business, labor, government and the public interest. The Subcouncils will emphasize cooperation between business and labor, between the public and private sectors, and between the Federal and state governments. They will include proponents of all responsible points of view to ensure that their analyses and recommendations will be balanced and comprehensive. They will be ongoing consultative forums that draw upon the best practices from American industry and labor, foreign countries and companies, innovative state programs, university and other research centers, and all other available sources.

We are hereby establishing eight Subcouncils:

- Capital Formation
- Education
- Training

... leadership ... with the ... and the ... ress, will be ... tial to launch the ... ss of reform. ... such leadership ... galvanize the ... ic support that ... crucial to the success of ... effort.

- Public Infrastructure
- Corporate Governance and Financial Markets
- Trade Policy
- Manufacturing
- Critical Technologies

The **Subcouncil on Capital Formation** will focus on strategies to substantially increase the US saving and investment rates. In addition to considering the Federal budget deficit, the Subcouncil will examine the potential contribution of fundamental tax reform (as described above) and the usefulness of individual tax incentives.

The **Subcouncil on Education** will develop ways to bring performance at the pre-kindergarten and K-12 levels to internationally competitive levels. It will consider Federal actions as well as steps that states, local school boards, employers, and labor unions can take. This Subcouncil will draw on the work of previous and ongoing commissions including the National Council on Education Standards and Testing. It will be chaired by Albert Shanker, President of the American Federation of Teachers and a member of our Council.

The **Subcouncil on Training** will have three goals: to develop a plan for more effective worker adjustment programs, to consider ways to encourage and upgrade training for all employees, and to make recommendations for needed improvements in education and preparation for work for high schoolers who do not go on to college. The Subcouncil will draw on the work of the Commission on the Skills of the American Workforce, the Secretary of Labor's Commission on Achieving Necessary Skills, and the National Advisory Commission on Work-Based Learning. The Subcouncil will be chaired by Lynn Williams, President of the United Steel Workers and a member of our Council.

The **Subcouncil on Infrastructure** will look at America's transportation, communications, information, and utility networks to consider what investments need to be instituted now to support American competitiveness over the longer run. The Subcouncil will draw on the work of the National Council on Public Works Improvement.

The **Subcouncil on Corporate Governance and Financial Markets** will seek to identify the specific corporate governance and shareholder trading patterns that impact the nation's competitiveness and growth, and make appropriate recommendations. It will be chaired by Edward Regan, Comptroller of the State of New York and a member of our Council.

The **Subcouncil on Trade Policy** will develop specific recommendations for how the United States can better promote exports, particularly of manufactured products, as an engine of growth. It will look at export disincentives at home as well as policies needed to open markets abroad, and the structure as well as level of US trade. The Subcouncil will work closely with the President's Export Council. It will be chaired by John Murphy, CEO of Dresser Industries and a member of our Council.

The **Subcouncil on Manufacturing** will consider how companies in a select group of industries can do better in stimulating innovation, speeding product development, boosting quality, and improving effective utilization of the workforce and labor-management relations. It will attempt to discern whether valid generalizations can be drawn for manufacturing as a whole. It will suggest what the Federal and state governments can do to improve the environment in which the firms and their workers operate. It will examine the opportunities and challenges of defense conversion. It will consider how workers can participate more effectively in improving the production process. The Subcouncil will build on the work of the MIT Commission on Industrial Productivity and the new industry centers established at several universities by the Alfred P. Sloan Foundation.

The Subcouncil on Critical Technologies will review the recently increased US Government efforts for developing leading edge technologies and evaluate them in relation to the efforts by competitors such as Japan, several European countries and the EC as a group, and Korea. The Subcouncil will propose policy, funding, and regulatory changes that may be beneficial to improving our technological base. It too may wish to look at critical individual industries. It will work closely with the private sector Council on Competitiveness which has developed many recommendations on these issues.

Although the Council believes that health care costs are a significant factor affecting US competitiveness, we are not setting up a Subcouncil on that issue at this time. Since several detailed plans are now being considered, the Council believes that it can be most useful not by devising a plan of its own but rather by analyzing the competitiveness impact of various plans as they emerge and make their way through the legislative process. The Council will thus keep the issue under review and return to it later.

Building A Competitive America

The Competitiveness Policy Council believes that improving the nation's competitiveness is one of the primary challenges facing the United States as it prepares to enter the twenty-first century. The degree to which we meet that challenge will go far to determine the prosperity of our people in the coming decades. It will help determine the world role, in security and political as well as economic terms, that the United States will be able to play in the post-Cold War world.

The Council believes that the historical record, recent signs of progress and unparalleled resources of the United States will enable it to meet the challenge effectively. It will not be easy to restore the competitive successes that characterized America in an earlier era, however. Many other countries are moving ahead rapidly and their momentum will be hard to catch. Ironically, the enormous assets of the United States still mask the slide which this Council feels has now become quite clear.

Leadership from all our public officials will be essential to launch the process of reform. Only strong leadership can galvanize the public support for reform that appears to exist and is crucial to the success of the effort. Only such leadership can bring together the necessary components of a comprehensive program. We believe that the American public is ready to respond to such leadership and is in fact starting to demand it.

The America that could result from such an effort would be far stronger than it is today. It would take a much longer run view than it does now. Its laws and regulations would enhance American competitiveness. The country would be fully cognizant of its deep integration into the world economy and recognize the central importance of superior performance as measured against global standards.

Such an America would fulfill our definition of competitiveness— meeting the test of international markets while its citizens earn (rather than borrow) a rising standard of living that can be sustained over the long run. We commend this vision to the President and Congress as we present them with this First Annual Report, and look forward to contributing further to its realization with our work in the months and years ahead.

About Our Members

RAND V. ARASKOG has been Chairman, President and Chief Executive Officer of the ITT Corporation since 1980. He is also chairman of the Supervisory Board of Alcatel N.V, ITT's joint venture with Alcatel Alsthom of France, the world's largest telecommunications manufacturing company. Mr. Araskog is a director of several corporations, the New York Stock Exchange, and the Federal Reserve Bank of New York. He is a member of the Business Roundtable and author of *The ITT Wars*. He spent five years at the Department of Defense during the late 1950s.

JOHN J. BARRY is the International President of the International Brotherhood of Electrical Workers, a position he has held since 1986. He started as an apprentice in the electrical construction industry in 1942 and has held numerous elected positions in organized labor since 1962. He is a Vice President and Executive Council member of the AFL-CIO. He serves on many boards including the U.S. Council for Energy Awareness and the American Productivity Center.

C. FRED BERGSTEN, Chairman of the Council, is Director of the Institute for International Economics, which he founded in 1981. He was Assistant Secretary of the Treasury for International Affairs from 1977-1981 and served on the senior staff of the National Security Council from 1969-1971. Dr. Bergsten is the author of 19 books on a wide range of international economic issues, most recently *America in the World Economy: A Strategy for the 1990s*.

WILLIAM GRAVES is the Secretary of State of Kansas. He was first elected in 1986 and is now serving his second term. He is a member of the board of the National Association of Secretaries of State and of Leadership Kansas. He is also a member of the American Council of Young Political Leaders and has served as an election observer in Taiwan. Mr. Graves is active in numerous civic organizations including the Kansas Chamber of Commerce and Industry.

JOHN J. MURPHY has been Chairman, President and Chief Executive Officer of Dresser Industries, Inc. since 1983. He serves on the boards of PepsiCo, NationsBank Corporation, and Kerr-McGee Corporation. Mr. Murphy is also Chairman of the Board of Trustees of St. Bonaventure University, and U.S. Chairman of the Trade and Economic Council. He serves on the Board of Trustees of Southern Methodist University and the Board of Directors of the U.S. Chamber of Commerce and the U.S.-China Business Council.

EDWARD V. REGAN is the New York State Comptroller. He was first elected to this position in 1978 and is now serving his fourth term. Among his many duties is the trusteeship of New York State's pension funds, whose assets now total over $50 billion. He was a member of the President's Commission on Industrial Competitiveness in 1983-85. Mr. Regan teaches at the Stern Graduate School of Business (NYU) and writes and lectures frequently on municipal finance, pensions, and corporate governance issues.

BRUCE R. SCOTT is the Paul W. Cherington Professor of Business Administration at the Harvard Business School, where he has taught since 1962. Mr. Scott teaches a course in comparative economic strategies of countries and has co-authored a study of industrial policy in France, an analysis of the Venezuelan economy, and more recently a study of the prospects for transition in South Africa. He is co-author (with George Lodge) of *U.S. Competitiveness in the World Economy*.

ALBERT SHANKER is President of the American Federation of Teachers, a post he has been elected to since 1974. He has taught in the New York City public schools and at the graduate level. He is a vice president and Executive Council member of the AFL-CIO. Mr. Shanker serves on numerous boards including the National Academy of Education and the National Council on Education Standards and Testing. His syndicated weekly column, "Where We Stand", has appeared regularly for over 21 years.

ALEXANDER B. TROWBRIDGE is President of Trowbridge Partners, Inc. which he founded in 1990 following ten years as president of the National Association of Manufacturers. He has held a number of positions in the public and private sectors including U.S. Secretary of Commerce from 1967-68, President of the Conference Board, and Vice Chairman of Allied Chemical Corp. He serves on ten corporate boards and is a charter trustee of Phillips Academy in Andover, Massachusetts.

EDWARD O. VETTER is President of Edward O. Vetter & Associates. He previously held a number of positions at Texas Instruments including Executive Vice President and Chief Financial Officer. Since retiring from Texas Instruments Mr. Vetter has served as Undersecretary of Commerce from 1976-77, Energy Adviser to the Governor of Texas from 1979-83, and Chairman of the Texas Department of Commerce from 1987-91. He is a director of the AMR Corp., advisor to several venture funds, and a trustee of The Massachusetts Institute of Technology.

LYNN R. WILLIAMS is the International President of the United Steelworkers of America, a position he has held since 1983. He is a Vice President and Executive Council Member both of the AFL-CIO and of its Industrial Union Department. Mr. Williams is a member of numerous organizations including the Collective Bargaining Forum, the National Committee for Full Employment, the Committee for National Health Insurance, the National Planning Association, the National Institute for Dispute Resolution and the Economic Policy Institute.

The Competitiveness Policy Council's Mandate

The Competitiveness Policy Council was created by the Omnibus Trade and Competitiveness Act of 1988. It is charged with making recommendations to the President and Congress on how to improve the nation's competitiveness. The Council's objectives, as stated in Public Law 100-418 (Section 5204), are to:

(1) develop recommendations for national strategies and on specific policies intended to enhance the productivity and international competitiveness of United States industries;

(2) provide comments, when appropriate, and through any existing comment procedure, on—

(A) private sector requests for governmental assistance or relief, specifically as to whether the applicant is likely, by receiving the assistance or relief, to become internationally competitive; and

(B) what actions should be taken by the applicant as a condition of such assistance or relief to ensure that the applicant is likely to become internationally competitive;

(3) analyze information concerning current and future United States economic competitiveness useful to decision making in government and industry;

(4) create a forum where national leaders with experience and background in business, labor, academia, public interest activities, and government shall identify and develop recommendations to address problems affecting the economic competitiveness of the United States;

(5) evaluate Federal policies, regulations, and unclassified international agreements on trade, science, and technology to which the United States is a party with respect to the impact on United States competitiveness;

(6) provide policy recommendations to the Congress, the President, and the Federal departments and agencies regarding specific issues concerning competitiveness strategies;

(7) monitor the changing nature of research, science, and technology in the United States and the changing nature of the United States economy and its capacity—

(A) to provide marketable, high quality goods and services in domestic and international markets; and

(B) to respond to international competition;

(8) identify—

(A) Federal and private sector resources devoted to increased competitiveness; and

(B) State and local government programs devised to enhance competitiveness, including joint ventures between universities and corporations;

(9) establish, when appropriate, subcouncils of public and private leaders to develop recommendations on long-term strategies for sectors of the economy and for specific competitiveness issues;

(10) review policy recommendations developed by the subcouncils and transmit such recommendations to the Federal agencies responsible for the implementation of such recommendations;

(11) prepare, publish, and distribute reports containing the recommendations of the Council; and

(12) publish their analysis and recommendations in the form of an annual report to the President and the Congress which also comments on the overall competitiveness of the American economy.

Acknowledgments

The Council appreciates the assistance of the following individuals, who made presentations to its meetings between September 1991 and February 1992: David Aschauer, Erich Bloch, Barry Bosworth, Robert Coy, Ken Edwards, Chester Finn, Ralph Gomory, George Hatsopoulos, Charles Hulten, Roberts Jones, Martin Lipton, Jay Lorsch, Malcolm Lovell, Ira Millstein, A.J. Pearson, Uwe Reinhardt, Charles Vest, and Robert White.

Valuable advice on this report was received from Dan Burton, Richard Cooper, Ben Friedman, Ellen Frost, Kent Hughes, Ken Jarboe, Ray Marshall, Van Doorn Ooms, Michael Porter, Lee Price, Robert Reich, David Richardson, Isabelle Sawhill, Robert Shapiro, Paula Stern and Lawrence Summers. Our work has also benefitted from extensive consultations with key members of Congress and their staffs.

The Council is also grateful to the following people who assisted in the various stages of producing this report: Martha Hall, Gilah Langner, Chongshan Liu, Coleen McGrath, Alda Seubert and Michael Treadway. DRI/McGraw Hill assisted in preparing the graphs. The report was designed and typeset by Wordscape, Inc. and the cover was designed by Supon Design Group.

The Council reserves its greatest appreciation for the yeoman support of its own staff members, Steve Charnovitz and Howard Rosen. They have organized and supported our work throughout the process and this report would have been impossible without them.

STATEMENT OF RAND ARASKOG, MEMBER, COMPETITIVENESS POLICY COUNCIL, AND CHAIRMAN, ITT CORPORATION, NEW YORK, NEW YORK

MR. ARASKOG. Mr. Chairman, members of the Committees, I'm pleased to be here.

At our first meeting, Senator Garn, I suggested that the best thing our group could do was to turn back the money that you had appropriated and for each of us to write in ten pages what our thoughts were on each of the competitiveness areas, put that into a document and send it to you and have done with it.

I was surprised that I was alone in that opinion of all the people in the room, because, like you, I felt we all knew what we were doing wrong and that we just had to get our act together to do it.

Well, I must say that over the period of the last several months that I have changed my mind entirely. I think the way that Dr. Bergsten has run the group; the people that are in it; the first sessions—I never thought I could get along with Lynn Williams. He's not here today, but I find as time has gone on that he has some very good and thoughtful ideas, as does Jack Barry, and that we all did have something to contribute.

I felt, initially, having children and a wife who has been a schoolteacher and school board member, that I certainly knew as much about education as MR. SHANKER. I found that also to not be entirely the case.

What I have tried to bring to the Committee is a deep sense of concern about the fact, as you've all stated, that our country favors debt-over-equity.

We double-tax dividends of public corporations. We allow debt to be fully deducted. We created an environment for take-overs, mergers, and acquisitions based on debt. We did the same thing in industry that we did in government, and we're paying for it now.

We move the management of much of America from corporate headquarters around the world, from San Francisco to Minneapolis to Richmond, onto Wall Street. And I think we have to stop that now, or we're going to continue with tax policies and programs that do not create jobs.

Now, I haven't heard it said since 1980 that a principal objective of an American corporation is to create jobs. I've heard shareholder value. I've heard about the benefits of layoffs to the stock price. I have not heard about job creation.

Now, finally, when we're in trouble, we're hearing about it. My company owns a finance company. Last year, we had 100,000 of our debtors go bankrupt in our consumer finance company alone. They were out of work. And we have the problem of getting them back to work.

My company has about the same level of employment that it had when I took office. We have had some divestitures. But it seems to me that over the last ten or so years that we have relied on small businesses and new companies to create jobs. And we have watched one large company after another in lay-off modes, and I think a lot of it has had to do with our short-range view, our debt-equity programs, and the fact that we were unwilling to recognize that Wall Street should not run American business.

So, I have felt that we have something to do, that we can make reports to you that will be meaningful, and that hopefully some major portions of them will be listened to. While we have a consensus report, I think the public record of our meetings would show that several of us on various occasions were "at each other's throats," in the sense of real sensitive disagreement on how important is consumption taxation, value-added tax, energy tax versus constant fooling with income tax, and constant changes in business taxation which jerks business around.

For example, the new program that would tax annuities.

One part of the U.S. economy—the middle class—most of the people buying those annuities earn less than $50,000 a year. They are buying those annuities with after-tax money. They do not get the benefits until their retirement, and we have a proposal to eliminate them at the same time we're saying we should do something for the middle class.

So, not being too emotional about it, I hope we do have something, sir, to contribute. We'll work hard if you keep our charter going. I think we have an excellent staff. And I hope very much that something positive, for a change, can come out of this in the Congress.

I thank you.

SENATOR BINGAMAN. Thank you very much.

Mr. Regan, please proceed.

STATEMENT OF EDWARD REGAN, MEMBER, COMPETITIVENESS POLICY COUNCIL, AND COMPTROLLER, STATE OF NEW YORK, ALBANY, NEW YORK

MR. REGAN. Mr. Chairman, Senators and Congressman Fish.

I will chair a subcouncil on corporate governance and the financial markets. It's appropriate for me to follow up on Mr. Araskog's comments.

By virtue of my office, I run a couple of fairly large pension systems, and, therefore, we are a very major shareholder in corporate America. I have no problem speaking for my beneficiaries—well over a million—with Rand's comments, that a purpose of a corporation is to create jobs, and perhaps that has been lost in the shuffle. It's been lost in, I think, some of the corporate governance battles and shareholder activism that has taken place in the last 4 or 5 years.

So, our subcouncil will be composed of the leading CEOs and academicians and people from the regulatory agencies here in Washington and New York to look at the issue:

Is the purpose of corporations solely to create shareholder gain, or is it to create something that I will call corporate health—corporate health versus shareholder wealth? Or, in the longrun, are they both the same? I would like to think that they are, but we will get expert testimony on that and, hopefully, contribute to some shift in the thinking of institutional shareholders as they view corporate America.

We will look at accountability. We will look at the German and Japanese systems of corporate governance and how they relate to their shareholders and compare it, and how our CEOs and boards relate to their shareholders here in this country. We'll look at the signals that the financial markets send to CEOs for short-term performance and whether that's a red herring or not.

It is often said that the rapid turnover in the stock market creates disciplines or an environment for short-term performance. I'm just not sure. It might be a lot of other things, some of which have just been addressed right here.

At any rate, our subcouncil on corporate governance will look down the barrel of the gun with the Nation's experts. Our executive director, Carolyn Baccato, is a national expert in the field. She is here with me today, and we will hold three quick hearings and wrap up. I think we can make a contribution and resolve this debate on what corporations are all about, what shareholders are all about, and whether or not there are short-term signals, and whether or not we can cure our own problem.

My own belief is that we can.

Let me conclude by recalling to you an experience that I had when I was county executive in Erie County, which is in the western part of the state.

I was running the environmental programs there at the time and I saw a number of polls that were done in the mid-1970s as to how people fel—the voters, the taxpayers—about environmental programs and on the question of a tradeoff of jobs.

Even in the 1970s, they felt very strongly that there ought to be more work done to rein in environmental degradation, even if it meant, in some of the cases, a tradeoff of jobs.

When the same questions were put, though, to the leaders—people like myself, people like yourself—in the mid-1970s, we didn't feel that way. We had a different view from the people and valued the job retention more than we did environmental degradation.

The more important question, though, was this: How did the leaders in the mid-1970s think the people felt?

We had a real misconception. We felt that in the mid-1970s that they thought like we did. They didn't at all. They wanted work done on the environment more than we thought they did.

My own sense, as Fred has echoed, is that we are in a similar situation today. I think the public understands economic sclerosis. I think that, and the chairman has been with me when this has been discussed, that when we talk to our people at the rotary clubs and the Kiwanis and the chambers of commerce of this country, that if you characterize this nation as having economic—and I use this word very carefully—stagnation, you're not going to be hustled out of the room as being unpatriotic, and you'll hit a responsive chord. In fact, if you don't say it yourself, the audience will say it for you.

So, my own view is the public understands this more than we think they do and perhaps more than many of our own leaders do.

About the mid-1970s, several things occurred in the country and Fred has alluded to them. And they all occurred at the same time. Rate of savings declined. The educational scores—and Al will attest to this—started to decline. And capital investment, especially the public capital investment per worker, the infrastructure per worker, declined, too.

They all broke at the same time, 1973 being as good a date as you can get.

Not unsurprisingly, at the same time, our rate of growth in productivity and our real incomes declined, too. That is not uncoincidental. If you have less public capital works behind each worker, you will get less productivity. That's a fact. And with less productivity, you get less take-home pay, lower real incomes.

So, we have laid out, and I think accurately and correctly, that, in fact, there is a long-term problem. I think that people know it. I think, and I've governed, as you have, Senator, in a city, Buffalo, where there was 14 percent unemployment in the mid-1970s. I never felt the concern at 14 percent unemployment that I feel today at 7 percent unemployment. And there's a very real difference as to why on the streets of Detroit and in the streets of Buffalo that you get a different feeling with those sharp differences in rates.

In the mid-1970s, they didn't feel that this country was in a period of economic stagnation; in fact, we were growing, we were the best in the world.

And so, they knew that, even at 14 percent unemployment, that would end and jobs would be restored and there was hope and faith in corporate America to produce jobs, as Rand says.

That isn't the case today. That's what has surprised, I think, the politicians, the candidates running for office, and the anger they feel. And they'll say to me, "Well, my gosh, it's only 7 percent unemployment. What's going on? Why are we surprised? Why were we bushwhacked, mugged on the way to re-election here?"

And the answer is that the public understands, and maybe even more so in a post-Cold War environment where the focus is not on not having that concern and they are, focused on the Nation's economic stagnation and wants, I believe, the candidates to talk about it.

We have a comment—about 8 or 10 words—on page 27 that I think is quite appropriate, and I'll wrap up right there:

> ... the most likely return to prosperity lies in addressing the structural problems and, thus, restoring confidence in the long-run prospects for America.

Senator Garn—my own belief—and I know the difficulty of getting people together. In New York State, we understand the problem of partisan politics up there pretty well. It's one big back alley in partisan politics business.

But, at any rate, my political instincts tell me this, Senator, that if we set about addressing, even if it is pain, the long-term problems in this country that the voters will understand and confidence will be restored. And if we just do the quick fixes—they understand that far better than we think they understand it—it won't work.

I conclude on that notion. I look forward to working with this group and helping you in a very difficult time to draw a consensus.

I believe, and I'll part slightly from Fred here, we ought to throw the fat in the fire right now. I'm sorry our reports are coming out on November 15th. They ought to be out on October 15th, and people ought to be forced to debate them—myself, Senator D'Amato, all of us. He doesn't disagree. None of us would.

I think the time to attempt to draw a consensus is right now, and I thank you for your efforts in that regard.

SENATOR BINGAMAN. Thank you very much.

Mr. Shanker, please proceed.

STATEMENT OF ALBERT SHANKER, MEMBER, COMPETITIVENESS POLICY COUNCIL, AND PRESIDENT, AMERICAN FEDERATION OF TEACHERS WASHINGTON, D.C.

MR. SHANKER. Mr. Chairman, members of the Committees, thank you for this opportunity to share these views. I guess that discussing education in this context may seem strange, but not really. If we go back to the 1950s and we think of a previous time when we felt that there was an emergency in education, it was around Sputnik.

Somehow, the Nation felt that the fact that they got up there first showed some shortcomings in our educational system and we tried to do something at that time in areas like mathematics, science and foreign language.

I think more recently, over the last decade or so, as we've developed this uncomfortable feeling about our ability to compete, one of views that has emerged very, very strongly is that you get countries like Japan, which have very few advantages in terms of natural resources, defying what were the lessons that some of us were taught in elementary and junior high school geography courses about what countries needed to have in order to be very successful. And if we take a close look, the usual advantages that were requirements in those days, many of these countries do not have. What they do have are very well-educated and disciplined work forces.

So, that leads us to take a look at what has happened in terms of our own educational achievements. It's not easy and there's a big debate that's going on as to whether things are bad or not so bad. There's a whole revisionist school now that picks up all sorts of numbers and says, well, none of these indicators are perfect and these tests all have some flaws in them. So we can't really tell.

I do not agree with that and I think that any fair-minded person who looks at everything that's out there will have to come to the conclusion that we are indeed doing very poorly in terms of academic achievement, when measured against all of our other industrial competitors.

Now, there are ways of making these comparisons. One way obviously, is the international assessments that are given every once in a while. And you have to watch them carefully.

If you check youngsters who are 17 or 18 years old in different countries against each other, you're indeed comparing different youngsters, because the number of youngsters who remain in school by 17 or 18 are so different in different countries that you develop a selective factor.

The chart that you'll find in our report, however, is 13-year-olds. About the same percentage of 13-year-olds are in school in all of these countries. And, therefore, you have in this chart, which puts us either at the bottom or tied for bottom in math and science with a number of countries around the world, an accurate reflection of where we stand.

I guess another thing to follow are the results of our national assessment of educational progress. There is, I think, throughout this country a fairly inaccurate view of what our problems are. I think most people in suburbia feel that their kids are doing pretty well. After all, the kids are about to go to college. And they say, yes, we have an educational problem but it's down the road. It's in New York City, or it's in Los Angeles, or it's in Chicago, or it's in Buffalo. But our kids are doing well.

Although we think that's serious, we wish those kids would do well, too. But our youngsters are doing fine.

Well, the national assessment, which has been done periodically for over 20 years, shows that we're just kidding ourselves.

If we look at the percentage of youngsters who graduate high school, who really know high school mathematics, it's 5 percent of those graduating, not 5 percent of the cohort.

If we look at the number of youngsters graduating who can write a decent letter or essay, it's 3 percent of those graduating.

If we look at the percentage of youngsters who are able to read at a level of the *Washington Post* or the *New York Times*, which is essentially a college-level textbook, that's 6 percent.

Those are very, very small percentages. And if we then ask ourselves, well, how can we compare these figures with figures in other countries, just take a look at the high school graduate or college-entry exams in

Germany, or France, or England, or Canada, or Japan, or any of these other countries, and you'll very quickly be convinced that every youngster who gets into college in these other countries achieves at or above that of our top 3 percent.

Germany produces 30 percent of its youngsters who are equal to or ahead of our top 3 percent. That is not a minor difference. And I'd like to underscore one other point, and that is, if you have only 3 percent of the youngsters who are able to write a decent letter or essay—we're not talking about New York or Buffalo or Los Angeles, we're talking about suburbia—we are really saying that the overwhelming majority of the most advantaged kids who ever walked the face of the earth are not learning very much.

We have a very fundamental misunderstanding in this country as to what the scope of the problem is. It is much deeper and much more serious than we think it is.

To some extent, it's covered up by our college-entry standards. Parents and communities are able to feel good because their kids are going to college. Well, they're going to college basically because about 95 percent of our higher education institutions don't have standards. They recruit students to make sure that they're full. Only our elite institutions have certain standards that they hold to.

So, the problem is very serious and what the subcouncil on education intends to deal with is to look at some of these comparisons, take a look at some of the educational practices of our major economic and industrial competitors, and take a look at the role that establishing and setting standards plays in other countries. The Chairman properly indicated that we both served on a recent commission dealing with this issue, which highlighted the importance of establishing standards. I understand that the reports of that group are now being debated within the Congress.

We hope to look at some of those same issues, the establishment of standards and also incentives.

We certainly do not want to have a system in which a tiny percentage of our youngsters go to college and everybody else is prevented from having any further education.

On the other hand, we do want to look at the question of whether having sets of standards for admission to college-entry and other training programs acts as an incentive in other countries to get youngsters to achieve more, and whether a totally open system of higher education acts as a disincentive within this country.

So, we are concerned not only with the educational achievement of those youngsters who go on to college, but also the youngsters who don't want to go on to college and want to go directly into the work force. And we'll look at what other countries do in this respect; that is, to what extent might it be possible to establish some kind of student certification which would have some value in the market place, which would get students to work harder and learn more because, if they achieve a certain standard, their chances are a lot better in terms of getting a job sooner, or getting a better job.

Now, all of this is in the context of our system of education, which is highly decentralized, and we're, I'm sure, not talking about having a national school system or having the Congress of the United States set up a series of examinations for students. All these will have to be done in the context of our values and in our system of government.

But we hope that with other commissions, such as the one that the Chair mentioned, and ours, that it may be possible if we all point in the same direction to get some of these things done.

Just as Ned Regan said, in terms of the agreement of large numbers of the public, that in many cases, that they may be ahead of where some of the "leaders" are; I think that in the educational field that that's true also. I think that a lot of the debates that are out there are debates among a very small number of people, that if you look at the polls of parents and taxpayers in this country, they are ready for national standards. They are ready for saying that there are consequences for not learning.

They're ready for a lot of the things that we have these long debates about. I hope that as a result of consideration by this subcouncil and a representative group that we'll be able to be helpful in that decision-making process.

SENATOR BINGAMAN. Thank you very much.

I think our ground rules, since we have several members here, will be that I'll limit my questions to 6 minutes. The members who have come and have not had a chance to give an opening statement will be given a couple of extra minutes to make any kind of opening statement that they want. That way, everybody will get a chance to at least ask a few questions.

Let me also acknowledge for everyone that another person who gets a lot of credit for the legislation here on the Senate side getting done is Ken Jarboe, who's a staff person now on the Banking Committee. Ken is back here behind me and worked with me in my office at the time we did this, and has been working with Senator Riegle more recently, and has been very persistent in getting this organization established.

I'd like to just ask Mr. Araskog first about this issue of job creation.

As you may recall, the Congress directed that a special panel be established to look at the health of the semiconductor industry in this country at the same time we passed the trade bill that established this group. And Ian Ross at Bell Laboratories was head of that. They came out with their final report, their third of three reports, two weeks ago, and the report had in it information about the decline in the number of jobs, not just in semiconductors, but in electronic products generally—the decline in the U.S. employment in that sector of electronic components.

What it heightens for me, and I had a visit with some people in the semiconductor industry about it—I don't know that it applies as directly to their sector of the electronics industry—but it's pretty clear to me that

U.S. firms are under pressure to locate plant and create jobs in the European community if they want to do business in Europe. They're under pressure from those governments to locate plants and to create jobs in Japan if they want to do business in Japan, and in various countries that we do business in.

Similar pressure is not generally applied to foreign firms that want to do business here. There's not a requirement that they produce their product here if they want to sell it in our market.

I've wondered, we have a lot of debate that has already gone on, which is going to continue to go on as this Mexican free-trade agreement becomes a larger and larger issue here in the country, as to what kinds of incentives and inducements the government should look at, first of all, to encourage U.S. firms to stay here, whenever possible, and create jobs here for our own citizens; and second, to encourage foreign firms that want to do business here to create jobs here.

It seems to me that that's an area that we haven't seriously addressed in the tax code, or in any of our various policies. Unfortunately, it's a subject, when you bring it up, that usually falls into the category of protectionism and everyone's opposed.

But I'd be interested in any comment you have as to whether that's an area that needs attention by your Council.

MR. ARASKOG. I think it does require a good deal of effort. As you know, our corporation is in a lot of areas of the world, and we're treated in different ways in different areas of the world. In some areas of the world, you can only dividend out a certain amount of your total assets under the laws of the country involved.

In some countries, you have to take on a joint venture partner, whether you want to or not, and he has to be the majority owner.

I think that the pressure inside of Europe now is going to be to continue to want to have the production in Europe wherever possible—job creation in Europe. And as far as the United States is concerned—from my vantage point—we have been super generous. Only recently did we start to tax foreign firms as heavily as U.S. firms. And even recently, too, our IRS has gotten very much involved in how foreign firms are moving money around so that their U.S. subsidiaries—strangely enough—don't seem to show much income.

I think we need a lot more work done in this kind of area, because I think we really have not paid attention to what other countries are doing with respect to investment there and what we're doing with respect to investment here.

I think it's a worthy area of a very careful analysis and report.

SENATOR BINGAMAN. Thank you very much.

Let me ask, Fred, for your comment on this, or anybody else who would like to comment. I don't know if you'll be able to get into this, but in the area of manufacturing, an obvious obstacle which we have to deal with is that we don't have anybody in charge of manufacturing in our government. We don't have a department of industry or technology. We have it scattered around.

The Department of Defense makes substantial investments in related issues. The Department of Energy does. NASA does. The Department of Commerce, through NIST, does.

But one of the problems we've had, which I indicated in my opening statement, is that we tried to legislate the establishment of a national manufacturing extension program. The problem is the Department of Defense says: "This isn't our job. It's not our problem if manufacturing goes south, or basically goes out of business. That's someone else's job."

We are locked into minimal budgets in other areas that might take an initiative. Year-after-year, the inertia of the system keeps us from appropriating any significant money.

My latest information is that we spend $80 million a year nationally on manufacturing extension. That's through the Department of Commerce budget. We spend $1.1 billion on agricultural extension. Of course, manufacturing accounts for nearly 20 percent of our gross national product. Agriculture accounts for 2 percent.

So, do we have to reorganize the Federal Government to get this thing fixed? Is that something that you folks will be looking at, too?

Every time you reach that conclusion around here, you generally are going down a blind alley because you can't get it done. Without presidential leadership, you cannot reorganize the Federal Government. I've concluded that. And we don't seem to have any in that area.

So, any thoughts you have, I'd be interested in hearing.

MR. BERGSTEN. Mr. Chairman, we agree with you on that. On page 33 of our report, we have the following sentence: "Our present governmental structure was not designed to help this country compete in a global economy."

That embraces the point you make and even goes beyond it. And we go on to suggest that there will have to be changes in our governmental structure, either changes within the executive branch and/or by having one of our independent agencies play a much more active role in taking a look at where particular American industries are likely to go; how that comports with our vision of a prosperous country; what the foreign competition is doing and how that will affect our competitiveness in the future.

We did not in this report go into great depth on specific mechanisms. But, again, unanimously, we agreed with the need to change in the direction you're talking about.

SENATOR BINGAMAN. My time is expired.

Senator Riegle, please proceed.

SENATOR RIEGLE. Thank you very much, Mr. Chairman.

Let me first make a reference to a work that predates this work. It's interesting. Mr. Regan, you are the only member, as nearly as I can tell, that was a part of the President's Commission on Industrial Competitiveness back in 1983 and 1985.

MR. REGAN. That's right.

SENATOR RIEGLE. You have the unique value in terms of being a bridge from that earlier effort in the early 1980s. I remember that work very clearly. Michael Porter was involved and many others.

MR. REGAN. That's right.

SENATOR RIEGLE. Several of us here did everything we could to try to promote the findings and the observations of that group effort.

It sounds very much the same to me just in reading through your booklet today. We're roughly a decade further down the road, or nearly so, but the same points are being made.

I think they've been made very well here today, and my hope is that we're going to be able to marshal the kind of national consensus that will allow for some changes in our policy decisions.

We're still struggling with this notion that somehow, if we don't organize ourselves and think together, we'll get a better answer. There's still this invisible-hand notion that says that if everybody leaves hands-off that, somehow, magically, the right things will get done. I think all the evidence is to the contrary.

MR. REGAN. That's right.

SENATOR RIEGLE. In the kind of new global economy we're in today, that just doesn't work properly and nations fall behind if they adhere to that notion, that there has to be thinking and strategic planning and goal-setting in a variety of areas, as diverse as education on the one hand, across to manufacturing sciences on the other.

And I've asked somebody to get me one of those reports back from the early 1980s so that we can make some reference to it in today's context.

Also, I want to acknowledge Bruce Scott, who serves as the Paul Charrington Professor of Business Administration at the Harvard Business School. That has special meaning for me. Paul Charrington was my mentor at the Harvard Business School years ago. Seeing you here and carrying the name of the chair endowed in his name is special to me just on a personal level.

I'm struck, Mr. Araskog, by your frankness in saying that one of a corporation's central purpose is to create jobs. That gets said so infrequently, that it's almost like a brand-new thought. But it's a very valuable thought for you to express, and particularly because, if you look across the American landscape today, almost every large corporation is shrinking in size and reducing the number of jobs. It's almost like a who's who in American industry.

I mentioned General Motors earlier. Obviously, very relevant to my home-state situation, but it's also true of IBM, AT&T, Sears & Roebuck and United Techologies.

It's very hard to think of very many large companies that are growing in size. I know Wal-Mart is growing, but it's a handful in comparison to the numbers that are going the other way.

It seems to me increasingly that that is true of even medium- and small-sized businesses. When you look at the bankruptcy—the statistics from last year—even the job growth that one normally associates with small business, small business has been having a very tough go for the last 2 or 3 years. Thank God we're getting some job growth there, as it is.

But I think it needs to be emphasized and strengthened that there is, as a part of the corporate responsibility, job creation. And I think Senator Bingaman makes a good point, and that is job creation hopefully here in America, where we all live and have to try to survive and thrive as a society, we ought to be doing it here.

I want to make a reference to page 2 and 3. You make the comparison with Japan on the bottom of page 2. You say:

> With only half as many people as America, Japan has invested more capital in its future productivity than we have—in *absolute* amounts—for the past 3 years. It has been spending more relative to the size of its economy,on civilian research and development. And Japan has overtaken US industry in a number of key sectors.

And then you drop down and you say:

> Competitive economies must succeed at the frontiers of manufacturing and technology. Manufacturing generates far higher productivity gains than services. It accounts for almost 80 percent of our international trade. Hence, manufacturing is of crucial importance to American competitiveness. Yet we have already ceded leadership to other countries in a number of cutting-edge sectors and are now experiencing unprecedented challenges in a wide range of emerging technologies.

Now, I would say that today, generally, in what floats around in economic circles and editorial board circles and so forth, people don't put much stock in manufacturing. Manufacturing seems and sounds and is treated as passe.

The world of the service economy and high-tech and so forth and so on is somehow put out there as something that is disconnected from manufacturing plants—work floors where people actually gather to make things.

Can any of you help illuminate more clearly why manufacturing, in your view, according to this conclusion you've stated, is so important? And how do we put a fresh face on the importance of manufacturing, as part of our national living standard, if in fact it is as important as you say?

Mr. Araskog, what are your thoughts?

MR. ARASKOG. Well, I think one of the crucial things about manufacturing is that the cash flow for manufacturing is typically very strong.

It's typically stronger than for service industries, in terms of numbers of employees.

In our own company, we have both manufacturing and service sectors and we rely primarily on the manufacturing sectors for cash flow. We can get reported net income in the service area as well.

I think this is one factor.

I think a second very crucial factor, though, for the country, I've heard a statistic that one manufacturing job creates 1.6 service jobs. I don't know if that's exactly accurate or not, but clearly you can't have a strong service economy, I don't believe, in a country the size of the United States without a strong manufacturing economy as well.

Mr. Regan. Senator, when the Wal-Mart malls move into your state, into my state, with their job creation, the little downtowns in your smaller cities are going to turn into ghost towns.

There is no job creation there. People don't buy more pots and pans because there's a Wal-Mart mall versus a downtown and a small city. Wal-Mart is called the angel of death. I don't want to see them listed as somebody that creates a well-run corporation, but not job creation.

So, Mr. Araskog, of course, is absolutely correct. It's the export industries that create the jobs.

How do we get them? Well, you heard Mr. Shanker give you a statistic about comparison of education here and in Germany. If you were going to locate a plant and you needed skilled workers, or you wanted to expand a plant—I don't care whether it's a U.S. plant or a foreign plant —where would you look to, given the statistic that Al quoted? And then look at the chart there.

How come it takes us five hours to get from New York City to Boston on a train? And you actually stop in New Haven because the tracks change size. Imagine that in Germany or Japan.

Where are you going to locate if that's the kind of public infrastructure that's there, which, of course, is pulling down your productivity per worker if you have to send people back and forth between those two cities.

So, fundamental for job creation is human capital and physical capital. Al Shanker addressed one. The chart addresses the other. And at that point, job creation can become more of a reality, as it was in the 1970s, and that's the defining difference I think between today and maybe the defining difference between these two reports.

Look at the title, "Global Competition–the New Reality." That's the PCIC—the report of the group that I was privileged to serve on. The two differences are very clear, and I think the defining difference between these two reports is that this was presidential only, this is Congress and the President. That's the difference.

Not that we haven't had strong support from the Administration. They've been very involved in this. And we took the report right to the White House yesterday.

When John Young—and this is a presidential report—finished this work, the chairman of Hewlett-Packard and the chairman of this was relegated to a small room in the Department of Commerce. That was it.

SENATOR RIEGLE. I remember that.

MR. REGAN. That was it. The difference here, I think, from the two reports is very strong support from people like yourself, the Chairman and other people that are here.

We were relegated off to the side because there was never a hearing on this of this nature, and that's the defining difference, your support.

SENATOR RIEGLE. Let me just finish the thought and yield. My time is up.

In essence, this report, seven years ago, says the same thing that's in this report today. Now, they're updated and they take account of data in the meantime. But, in effect, you sounded the alarm and the alarm was sounded by a broad coalition of business and labor leaders seven years ago in America. Basically, we haven't moved with respect to any kind of an overarching, comprehensive strategy since that time.

I want to support what you've said. I don't think, and I want to say to Mr. Bergsten, who I respect very much, I think the idea of finessing this issue another several months—this is a bipartisan group—whatever the facts are, they ought to be put on the table. We're at least seven years late now. And to wait another 7 months or 8 months because of the delicacies of the political year is just an outrageous notion.

That's what's killing the country, the fact that we can't be honest with ourselves and put the cards out on the table face up.

We're 7 years late and we ought not to add and compound that felony by delaying this any longer.

Thank you, Mr. Chairman.

SENATOR BINGAMAN. Before introducing Congressman Fish, I'd like to introduce into the record Senator Sanford's opening statement.

[The written opening statement of Senator Sanford follows:]

WRITTEN OPENING STATEMENT OF SENATOR SANFORD

Thank you Mr. Chairman, and I too would like to thank our very distinguished panel of witnesses for being here and for their excellent work on the Competitiveness Policy Council. It is a special pleasure for me to welcome my good friend Rand Araskog to this hearing room.

I want to commend the Competitiveness Policy Council for taking on what I believe to be one of the most crucial issues facing our Nation—how do we get out of our downward spiral of competitiveness. I think we all must be disconcerted by the report's conclusion that America's economic competitiveness is eroding slowly but steadily.

I am glad to see the Council promote a comprehensive approach to our problems. I share their general view that our problems have developed over more than a decade of buildup in debt, financial disarry, and the neglect of our infrastructure and educational systems. Because these problems have been built over at least a 10-year period, it will take a long and sustained effort to solve them.

Again, I appreciate the efforts of our panel and the work that they have done to produce this report. It is one that the Congress must heed. These are crucial issues and I hope that we will make every effort to take up their recommendations, work them into legislative form, and begin the debate soon. The Nation cannot afford to wait much longer.

SENATOR BINGAMAN. Representative Fish, please proceed.

OPENING STATEMENT OF REPRESENTATIVE FISH

REPRESENTATIVE FISH. Thank you, Mr. Chairman.

I think this is an extremely exciting time and an awfully worthwhile effort.

Since I'm new in tracking the work of the Council could, I ask the question of anybody who would care to answer as to the six priority issues that are mentioned, starting with savings and investment. How were they chosen and what was the criteria? What was left out?

MR. BERGSTEN. If you will look at the list, it listed what we all felt was the whole agenda for competitiveness, which, of course, in a broad sense, relates to the economy as a whole. Mainly to be manageable for our own operations, but also because we thought it was critical to select priorities, we had an extensive debate as to what were the most important areas. And these were the six we isolated.

Now, those six include some subheadings. Under savings and investment, we have public infrastructure spending and we've set up a separate subcouncil on that now. We have that off separately.

Education includes both primary and secondary school education, and also training of the work force, and retraining in adult life, training in that sense.

So, it's really more than six issues, but these were the result of our effort to define what elements of the economy in the society had the most critical impact on our issue, which was American competitiveness.

We have a running list of additional topics that we've talked about. We may want to look at it in the second year of our operation, but these were the ones that we decided at the outset had the most impact on competitiveness, and where we thought policy change might be most likely and most helpful in improving the country's performance.

REPRESENTATIVE FISH. I notice that you have three prominent labor leaders on the Council. And for that reason, I find the absence of manufacturing strange.

MR. BERGSTEN. Well, if you will look at the list of subcouncils that we're setting up for the next phase of the work program, there is one explicitly on manufacturing, perhaps a little misplaced, and I would plead guilty on that.

Under the heading of technology, we have some very strong statements. In fact, the Chairman referred to them in his opening remarks about the importance of manufacturing and how it has been devalued in the attention of the United States, in both public policy and corporate efforts in the last 20 to 30 years.

So, on substance, we agree with you on that. We have a subcouncil that's going to be working on it. It's going to be chaired by one of the premier corporate executives in this country. It will bring in the labor people very actively, and I think when we come back to you, we're going to have some very substantial recommendations in that area.

REPRESENTATIVE FISH. That brings me to a question that's already come up, and that is how the Federal Government might be structured to be more responsive.

Of course, we do have the USTR now, in addition to the groups that you mentioned on page 33 of the report—the Secretary of the Treasury and the Fed Chairman.

But this is only—it seems to me—going to create tension between the classic responsibilities of the Department of Commerce, the responsibilities of the Department of Defense, and now the USTR.

I think that's something that could be studied. Maybe it already is by some congressional committees that have oversight responsibilities, like in the House—the Government Operations Committee. But I do think that there's a lack of sharp focus and accountability in the areas that you're talking about where trade is only one of six elements and you're pulling all of this together. I think it would be very helpful to have a look at how the Federal Government can have the same focus that you're recommending.

Thank you, Mr. Chairman.

SENATOR BINGAMAN. Thank you.

Senator Sasser, please proceed.

SENATOR SASSER. Thank you, Mr. Chairman.

First, Mr. Chairman, I want to compliment you for the very splendid work that you've been doing in this area for a number of years, sometimes almost single-handedly here in the Senate. And I want to pledge to you that I intend to redouble my efforts to see that more attention is focused on the problem of competitiveness and that we do a better job of funding some of these initiatives of yours than we've done in times past on the Appropriations Committee.

I think that today we are faced really with an historic opportunity if we will just take it.

The end of the Cold War—it appears to me—should mean that resources can be redirected to better meet the needs of the country and to the safer world that we live in.

It appears to me that we ought to be redirecting the so-called peace dividend to try to meet some of the long neglected needs of the country.

That's easier said than done because we now find that the peace dividend is not nearly as large as we had anticipated, and we find that there's great political resistance, really, to trying to reduce defense spending because of parochial interest in local defense operations. And it's going to take a little longer to try to realize a peace dividend, I think, than some of us anticipated.

I think that's most unfortunate.

But, gentlemen, I note that in your very excellent report that you call for the budget deficit to become a budget surplus.

Now, as chairman of the Senate Budget Committee, I'll just have to tell you that that's a lot easier to say than to do. And I expect you all realize that.

But with the economy in recession, and with a continuing long-term problem of competitiveness, it's apparent that the economy, I think, now needs investment more than anything else, both public and private investment.

Now, some have advocated, including myself and the distinguished chairman of the Joint Economic Committee, Senator Sarbanes, that perhaps we should channel some of our resources right now into investment, both in terms of physical investments, such as the Nation's infrastructure, and in human terms, Mr. Shanker—investments in education.

The question I want to pose to this panel is, do you agree that public investment makes sense in both the short- and the long-term, in view of the fact that we have a significant budget deficit?

Should we, in the short-term, perhaps consider enlarging that deficit to a moderate amount to make investments in the infrastructure or not?

What do you say?

MR. BERGSTEN. We took several strong views on that, Mr. Chairman. And I might say that, as you know, we sent officially a copy of our report to you as chairman of the Budget Committee and we're hoping to consult actively with you as we continue our work.

We took the view, as Ned Regan said earlier, that the best short-term economic policy for America is to start dealing with the long-term problems, these underlying difficulties we've talked about.

Then we went on and asked how we could do that in ways that would also contribute to the immediate need for recovery. There we concluded that the best avenue was the one that you just isolated—public infrastructure spending.

As long as we can identify areas where the long-term infrastructure needs will be met, accelerating spending in that area seems to us, perhaps, the most promising way to blend the long-term needs with the short-term requirements of recovery.

We would agree, too, that increasing the financing available to keep education and training programs going would fit into that nexus as well.

We did go on to say that this was not leading us to shirk our view that the objective of budget policy ought to be to create a surplus over time. We didn't say when, given the uncertainties about recovery and how long it will take to get the economy back into shape. But we did say that if one increases the budget deficit now, perhaps for short-run recovery reasons, it simply adds to the task that you, in particular, and all of us will subsequently face of trying to move the budget into surplus.

As we set up our subcouncil on capital formation, I mentioned before you came in, Senator, that the chairman of that subcouncil is going to be Peter Peterson, who has taken a leadership role in suggesting the need for budget reform and improvement, and we will try to come up with specific ideas that are politically possible for doing that in our next report.

MR. REGAN. I might add, Senator, without a capital budget, the Federal Government is unable to account properly for capital investment.

It's one thing to increase spending where it's automatically consumed. It's another thing to increase spending that is going to generate future income, and obviously, that's what capital investments are geared to do.

Some day, somehow, maybe through your committee or elsewhere, this notion of properly accounting for federal expenditures as they contribute to an increase in deficit or a decrease in the deficit will be done. You'll be able to look at capital programs, I'm sure as you know, a lot better.

Second, on infrastructure investments, I'm in favor because I think they have a different impact, even if they don't account for it the right way. The kind of infrastructure investment we have in this country sometimes doesn't lead you to want to make more. I call it the cut-the-ribbon-and-run philosophy.

Mayors and governors like to stand out there and snip the ribbon of the new bridge or the new plant and then take off, and you won't find maintenance being done over the next five or 10 or 20 years. They run. They'll cut the ribbon. They'll be there with you. But there won't be any maintenance.

And I would not want to encourage any new infrastructure investment unless, at the same time, you had bond covenants that required the recipient of those capital improvements to maintain them. And therein, you'd have a very sharp difference in the discipline of how those structures are picked, and, of course, the fact that they'll be maintained restores some public confidence a little bit, too.

Finally, where do we put our new infrastructure? Well, if we just put it out in green fields and build more sewer and water lines and highways to further depopulate our central cities, that's not a very wise investment. And yet, the Federal Government has been unwilling to put restrictions—and certain-ly state governments are cowardly about it—that would require investment in the infrastructure to be done in the present urbanized areas where it's really needed, and not just go out and create suburbs-on-top-of-suburbs-on-top-of-suburbs.

So, yes, it's needed, with a couple of qualifications that I've just suggested.

MR. BERGSTEN. Mr. Chairman, if I could, I'd like to introduce one more member of the Council, Edward Vetter, who has just arrived from Dallas. He is the President of Edward Vetter Associates and a former high executive of Texas Instruments. He is very much involved at MIT with its high-tech program. He's been a valuable member of the commission and I'm delighted to welcome him here.

SENATOR BINGAMAN. We're glad to have you.

SENATOR SASSER. Well, Mr. Regan, Senator Graham of Florida, a former governor, has called our attention in times past to the necessity for maintenance and has even made the point—I think very ably—that if you want to create jobs on infrastructure, you create more jobs faster if you get into the maintenance and restoration than if you begin by building totally new infrastructure.

Mr. Chairman, my time is expired, but if I could just take 1 more minute here.

Could we see that second chart? Would the staff take the first chart off so that we can see the second chart, which indicates the composition of U.S. debt as a percent of gross national product.

Looking at government debt on your chart, we find that government debt at the end of the Second World War, of course, represented about one and a quarter percent of all of the gross national product, and it was coming down steadily, slowly, but fairly steadily, until we got to 1980, 1981, and we've seen a tick up there.

But, still, we find that even though it's in excess of 50 percent of GNP, it's not as high as it was, for example, in the year 1955.

Now, if we returned to a full-employment economy, which most economists now, I think, say it is. What, Mr. Bergsten, 6 percent unemployment?

SENATOR SARBANES. Five percent.

SENATOR SASSER. Five percent, Senator Sarbanes says. But if we returned to a full-employment economy and we lose the hemorrhage of revenues caused by the recession, we would then be looking at a structural deficit of somewhere in the neighborhood of $180 billion.

Now, if we could reduce the defense aspect of the budget, now rounded off at somewhere around $290 billion in 1992 dollars, if we could reduce that spending by $100 billion and apply that to the deficit, then you would have a structural deficit, if everything stays frozen in place, of $80 billion in a budget of $1.5 trillion.

That's not that significant a budget deficit and one that we could handle.

I'm saying all of this to come around to the view that this Council, I gather, would not disagree with the notion that it might be wise to make investments in the short-term, even though they might increase the deficit in the short-term if, in the long-haul, you see that these investments are going to produce economic growth and make the country more competitive.

Mr. Araskog may want to say something to that.

MR. ARASKOG. I think I talked to this subject a little bit, Senator, before you came.

Certainly, I think investment tax credits, and I mentioned the dividend policy of the United States where we double-tax dividends. The Secretary of Treasury has testified before you, I think, many times, that there is a problem here, but because of revenue reasons, it can't be fixed now.

From a personal point of view, I would really disagree with that. I think an announcment on dividend policy that allowed U.S. corporations to pay out dividends from before tax money, or an even broader policy that exempted dividends from taxation at the individual level, too, would be exceedingly beneficial for the economy in the long run. It would cost something in the first year or two, but I think it's the kind of fix we need to get savings in the country, and to get equity back into the vogue where it ought to be, and get that debt down.

If you look at the corporate debt on that chart——

SENATOR SASSER. Right.

MR. ARASKOG.——we ran that up more than the government did.

SENATOR BINGAMAN. Senator D'Amato, please proceed.

OPENING STATEMENT OF SENATOR D'AMATO

SENATOR D'AMATO. Thank you very much, Mr. Chairman. Let me commend you for calling these hearings. And I'd like to take particular note of our comptroller, Ned Regan, and the outstanding work that he has done in this area over the years. He's certainly a source of great strength to us at home. And, of course, Rand Araskog and everyone; Al Shanker, a former New Yorker, who's now leading our efforts in education.

Mr. Chairman, I found most interesting something that Mr. Araskog just touched on briefly. I'm wondering if you might spend a few moments elaborating because it seems to me if we're going to compete, you have to have a level playing field.

I support the concept of free trade—economic competition—but there is an element that is missing called fairness. And when we fail, this country fails to see to it that there is fairness, or that the laws that are on the books are adhered to equally and applied with equal vigor. If you're a tax cheat and you're a U.S. corporation or a U.S. citizen, in a traditional sense, you run the risk of all kinds of penalties coming down upon you—civil, criminal and so on.

Mr. Araskog talked to the fact that there is a great deal of unfairness in competing. I don't know how U.S. corporations can compete successfully against someone who is not paying their taxes and literally escaping the payment of billions of dollars' worth of taxes.

Mr. Araskog, you talked about foreign subsidiaries here, and there are American subsidiaries not paying their fair share. Would you care to elaborate? Maybe I've overgeneralized it. I'll give you some statistics, though. But what do you pay—ITT, for example—what is your basic tax as a percentage against all the revenues you raise? What percentage?

MR. ARASKOG. Well, let me be very specific on a point here.

We just, as you probably read, made a sale of a major property in Europe. We will pay 32 percent tax on that sale. As a result, when we reinvest the money, we have to find a very good investment for that money if we're going to have the same total return that we got from it before we paid that tax bill, which we will pay.

In general, if a corporation is profitable, it is paying in the 30 to 32 percent tax area. If it's unprofitable or if it's overleveraged, if it has a lot of debt on it, it may be paying nothing. In fact, that whole corporate sector there and most of that household sector is all deductible. The 1986 bill, with respect to housing, allowed people to run up the loans on their houses all over the country and reduce their value, and the corporate tax structure which has said, you can deduct all those taxes against your income, which you can't do with dividends. And I think it's a real problem.

SENATOR D'AMATO. Well, Mr. Chairman, let me simply say that it is a great problem if you have American corporations who are paying their taxes and they have competitors here who are not. Let me give you an example.

Based upon basic sales that American corporations are paying, with the exception of some industries like the food and the retail industry, where their margins are very, very small—traditionally, they've been anywhere from a half percent to 1 percent—they're paying anywhere from 4 to 5 percent of their gross sales.

If you take a look at the foreign corporations and their subsidiaries here in the United States, they pay less than two-tenths of 1 percent.

Now, estimates have been made that we're losing, conservatively, $20 billion a year in taxes. So, not only is the Treasury losing these revenues, but in addition, how does the American competitor, who is paying his full tax load, who isn't using various devices which are back-loading charges, and the profits are being made by the parent corporation back in the foreign country—and by the way, this is not just the Japanese who are involved in this, our German friends and competitors are equally part and parcel in this. How do you compete? You're paying 30 percent. He's paying a fraction of that. Those dollars then can be utilized and are being utilized to continue to expand and improve the efficiency of his business.

I just think that our own laws that are on the books must be enforced with much more vigor.

I spoke to Fred Goldberg about this before he moved on, when he was the IRS commissioner. We put more money in the Treasury postal budget so that they could hire outside experts, because he said that some of these foreign corporations had the best of the best, and they just couldn't compete with them. And so we provided more money so that they could go after them.

But I'm just going to suggest that we're part of the problem by not seeing to it that there is that fairness and vigilence in the law being enforced.

SENATOR RIEGLE. Senator D'Amato, would you yield just for a minute at that point?

SENATOR D'AMATO. Certainly.

SENATOR RIEGLE. You offered an amendment on the floor sometime ago on the tariff classification.

SENATOR D'AMATO. Right. That was going to be my second point.

SENATOR RIEGLE. For multipurpose vehicles. I want to tell you that we inserted that yesterday in the tax bill reported out of the Finance Committee.

SENATOR D'AMATO. How many votes did it get?

SENATOR RIEGLE. Well, we got enough to report it out.

SENATOR D'AMATO. Good.

SENATOR RIEGLE. So it's in the bill. It's estimated to create 11,000 American jobs and to also bring into the Treasury $220 million of tariff revenue that the law requires, and has been evaded through these devices of zigzags and the application of the law and what I would call trade cheating.

But I just wanted to tell you that that particular issue was dealt with yesterday, and it is in the bill that was reported out of the Finance Committee.

SENATOR D'AMATO. That will make it harder for me to vote against the bill.

SENATOR RIEGLE. Well, we're trying to make it as appetizing for you as possible.

SENATOR D'AMATO. I want to thank my colleague, Senator Riegle, for bringing that up because a classic example of how our government ... and again, I don't blame the Japanese. They want to get more products in here. They're going to do anything they can. They hire the best lobbyists. The next thing you know a truck that they built becomes a car for tariff purposes. So that instead of having to pay the 25 percent tariff, this truck now miraculously becomes a car. They escape the payment of that tariff and save $200 million plus dollars, and it gets into this country.

And, by the way, when it is now a car to escape the payment, for classification as it relates to meeting safety standards, emissions standards and miles per gallon, it miraculously becomes a truck again.

It's that kind of thing that I think is pretty hard for legitimate, hard-working business concerns, no matter how competitive they are, to compete against. You just can't do it.

And then we show great strength and determination on the floor of the Senate when we get an opportunity to do something because the Administration brought this about. I guess Nicholas Brady has a difficult time distinguishing what's a truck and what's a car because he made that determination.

But we in the Senate don't have the courage to change it because we fall back on the fiction, well, that's a revenue bill and revenue bills have to eminate from the House. And so we won't even go on record as saying, hey, if it's a truck for one, it's a truck for the other. If it's a car for one and so on.

But I'm glad that Senator Riegle was able to bring this change about in committee.

One other matter—education. How are we going to provide a work force that can compete, Al, when we have so many youngsters today with a growing dependence on drugs and alcohol? And don't underestimate that alcohol problem and what it does in the work force. That drug and alcoholic problem has to just rob tens and tens and tens of billions of dollars in terms of productivity, and not even mentioning the incredible heartache it causes to families and concerns.

Isn't that an incredible problem, whether it's Mr. Araskog, who deals with it on a day-to-day basis in his own sector, or the whole community?

How do we deal with that more effectively in our educational plants?

MR. SHANKER. Well, it certainly is a problem. But I think that from the point of view of the subgroup that will be working on this, I guess since 1983, there probably have been over 100 national reports on education.

I think our job is to try to see if there are two or three points of leverage that can bring about some substantial change. I don't know that that's one of them, but there's no question that the schools are now taking in large numbers of children who have been so physically and mentally damaged that there's a question as to whether the schools can do anything about it at all.

SENATOR D'AMATO. Mr. Chairman, my time is up and I thank the panelists and I thank you, Mr. Chairman.

SENATOR BINGAMAN. Senator Graham, please proceed.

OPENING STATEMENT OF SENATOR GRAHAM

SENATOR GRAHAM. Thank you, Mr. Chairman. I too would like to commend you for your consistent and sustained leadership in the area of competitiveness and particularly your sponsoring the legislation that has brought this panel and this report to our attention, because I think it is an excellent framing of the debate that this Nation needs to have.

I'd like to make a brief comment and then ask a question.

I think one of the elements that needs to be strongly injected into this debate is a sense of urgency, that every month that goes by failing to attend to these problems inflicts a serious cost.

I met last week with a leading American health economist and she commented that in the early 1980s that most of our industrial competitors adopted a policy. And the policy was to try to restrain the growth in health-care cost to the growth in their gross domestic product. And that if you look at the charts, most of the nations who adopted that policy were relatively successful in accomplishing it. And, therefore, their line of GDP and their line of health-care costs are more or less parallel.

Ours have been going in that kind of a direction.

What is the consequence to the United States if, in 1992, we were to decide that we're going to adopt a policy of attempting to hold health-care costs, which I note is one of the key items in your list, at their current percentage of GDP, as opposed to letting the cost go where most economists think they will go 10 years from now unrestrained?

The answer is that it has a price tag to our economy in the year 2002 of approximately $1 trillion. That's the difference between restraining health-care costs to a current percentage of GNP, which is about 12.4 percent, and letting it go to the projected 2002 rate, which is approximately 21 percent of our GDP.

Every week that goes by without attending to that issue has an enormous future cost to our society and its competitiveness.

I say this in the context of the earlier discussion. I hope that you will forcefully bring this report and your future recommendations to the attention of the American people in time for them to take this into account in the 1992 elections, which I think in many ways is going to be a referendum on the 21st century and what kind of a nation we want to be as we go into the 21st century.

That's my editorial. Now, my question.

One issue that interests and concerns me as both a challenge and an opportunity is how we transition from a heavily military economy to a less heavy military economy. It's interesting that the former Soviet Union has seen their 400 to 500 military plants as being a key factor in that nation's ability to move into a modern marketplace economy.

The one place that the Soviet Union was relatively world class was in its military production, and frankly, it is an area in which the United States has been world class.

What do you think we should be doing in terms of this transition, which is an opportunity that is going to be available to us for the next two to five years, and then largely a moot point, if we passively sit by, including what should we be doing. Should we try to keep our military industrial plants that have been producing simulators for military applications together to produce those or analogous products for the civilian sector, or should we just let them disperse?

What should we be doing about the large number of talented people that are going to be coming out of military industries? How could that pool of human talent be most effectively directed?

MR. BERGSTEN. Senator, on your editorial, let me just say, we wholeheartedly agree. We identified the health-care cost issue for exactly the reasons you indicated. We have a Figure 22 on page 24 that shows those comparisons, dramatic as they are.

In fact, we were even more ambitious than you. We said the country ought to have a goal of rolling back the share of the GDP devoted to health-care costs to something like the OECD average. That would be an enormous change. Even your leveling off would be a very substantial improvement for the reasons you said. On the urgency point—and this also goes back to what Senator Riegle said a moment ago about our finessing some of the issues—we could only do so much so fast. But we felt every bit the urgency that you and he feel, and we're trying our best to help through our initial effort to inject all these issues into the campaign this year and to try and get a political base so that when the next Administration and Congress are in place, the issues will be action in all these areas. That is our intention. We're going to do everything we can to promote that.

On your question about the end of the Cold War and the conversion prospects, on page 30, we have a statement that very much echoes what you said. The end of the Cold War frees an enormous amount of high quality resources: human resources, physical resources, management resources and capital. In the two subcouncils we have set up, on manufacturing and critical technologies, we intend to look very frontally at exactly the issues you raised. In fact, in the marching orders to those subcouncils back on page 36, we say explicitly, those subcouncils will look precisely at those issues, try to discern—as we put it under manufacturing, "the opportunities and challenges of defense conversion."

We talk in this report about new governmental mechanisms to promote the role of the government in supporting civilian technology development. We talk about Senator Bingaman's manufacturing extension services. We talk about converting an important share of what the national labs do from defense work to commercially viable and important work.

So, we've signalled all those areas. We're going to be working on them intensely in our next round.

SENATOR GRAHAM. Thank you.

SENATOR BINGAMAN. Thank you very much.

Senator Specter, please proceed.

OPENING STATEMENT OF SENATOR SPECTER

SENATOR SPECTER. Thank you very much, Mr. Chairman.

In assessing our competitive position for the future, there has been appropriate emphasis on savings and avoidance of excessive consumption.

I would like to get your views on a proposal which Senator Domenici and I are offering and intend to put on the pending tax bill next week as a means of stimulating consumer purchasing power in the short run, but it turns on using savings and consumption.

In trying to find some way to stimulate consumer purchasing power and to give a boost to consumer confidence, Senator Domenici and I were looking at the availability of $800 billion in IRA accumulations and 401(k)s.

After the IRAs were discontinued for upper-income taxpayers, a proposal has come forward by Senator Bentsen and others, sponsored by 70-some senators to bring the IRAs back, but to use them for some purchases like first-time homebuyers, medical expenses and tuition.

Senator Domenici and I decided that we would use that as a format to use some of the funds available in existing IRAs and their first cousins, the 401(k)s. We added to those three items new-car purchases. The proposal is structured to enable middle-income Americans—defined as taxpayers earning $75,000 individually or $100,000 jointly—to have access to $10,000 to spend within six months on those items, with no penalty for those under 59 and no taxes paid in 1992, and in the five succeeding years, to replenish the IRA with $2,000 a year, or to pay taxes on the $2,000.

The thought is that with the knowledge that the expenditures were being undertaken by others, people are reluctant to spend their own money because they're worried about whether they'll have a job next year.

We have received an estimate from Chairman Greenspan that this would likely produce some $40 billion in expenditures as a stimulus to the economy.

I'd be interested in your views on the subject. Mr. Bergsten, would you start?

MR. BERGSTEN. Senator, we did not in our commission look at specific proposals of this type. We obviously want to do so carefully before we pass any group judgment on it.

I would say that our basic thrust is to focus on the need for greater saving over time. To the extent you divert money that's been intended for long-term saving into short-term consumption, you could be undermining that objective, to some extent.

Now, at the same time, we're fully cognizant of the need to promote growth in the short run. But we did underline the principle—and I mentioned it before I think you came in—that we really came to a pretty strong conviction that the best short-term recovery program would begin to deal with the long-term issues, including the savings rate and the need to bring the budget deficit down.

And so I think we would be guided by those principles in looking at specific tax or other proposals that come into the current debate.

SENATOR SPECTER. Well, Mr. Bergsten, are you essentially saying that nothing should be done in the short-run? When you talk about increasing savings, I quite agree with you that that's a long-term proposition. When you talk about reducing the deficit, we struggle mightily with that and have done a very poor job in terms of reducing the deficit.

But what we are searching for is something in the short-term, and also, not in the electoral sense, but the political reality of trying to give the American people some confidence that something is being done.

No one has said to the American people, yes, we ought to do nothing, or maybe some people have thought it, but very few people have said it. That hasn't been articulated as a proposition with any scope or any breadth.

A few people are saying quietly that they hope nothing happens.

But in searching for something to be done in the short-run, why not take a try? How much is it going to disturb American savings when we have $800 billion in IRAs and 401(k)s, and I'm told $3 trillion in

s—retirement savings, generally—if we were to take $40 billion
l spend it now?
not sure what it would do, but it would certainly be good news in
if people had $10,000 to buy a new car or to spend the money,
some people had an idea that something is being done. Senator
he advocate of the President's tax package, was quoted in the
d press to say that there was not a whole lot here as to what's go-
appen.
e searching for something to grab a hold of.
Shanker, why not take a flyer with this sort of a proposal?
SHANKER. Well, as Fred said, we did come to agree on some gen-
nciples and we, as a group, have not discussed either this specific
l or any other one. So, I'd want to look at it further.
BERGSTEN. Could I come back, though, Senator?
id not say do nothing in the shortrun. To the contrary, we said,
l Regan, I think, articulated this very eloquently early in the dis-
this morning, that to start rebuilding confidence in the economy
private investment and consumption going again, the most valu-
ng to do may be an attack on these underlying, long-term struc-
oblems that people feel are not being addressed.
having said that, we go on and ask your question, which of the
measures could also help in the short run?
n commenting earlier, I said that the group took a very strong
the area of public infrastructure investment, whose lag—as our
now—has been severe and which has clearly reduced the coun-
ductivity and growth, an acceleration of investment in that area
th help in the short run, create jobs, boost the economy and get
owing more rapidly, while also addressing the longer-run
.
scussed this quite explicitly and extensively in our commission.
f the proposed short-term measures would be consistent with
s we have on improving the long-run situation? That one clearly
he head of the list.
her point which is terribly important. We share exactly, I think,
that you're stressing of trying to restore consumption and get
in the economy up. But we come to the inexorable fact that to
you have to have a growing economy and productivity expan-
t requires investment. That requires savings.
ng the share of consumption in the short-run increases the level
nption, wealth, income and economic growth in the longrun.
gh to do it at any point in time. It should have been done 2, 4,
ago when the economy was stronger. It's much tougher to do it
e reason you said, no doubt. But we have the feeling that if the
ontinues to defer decisions that are needed in a fundamental
t the basics may just keep getting worse.

And that's why, with all due respect, I guess we would take a somewhat different view.

SENATOR SPECTER. Well, my time is up. What I would like to do is to submit some of the details to you on papers which have gone forward in other channels and invite your comments, if you would care to make them.

I don't disagree with what you say about investing in the infrastructure, but I don't think that that necessarily precludes this sort of an approach at this moment.

Thank you very much, Mr. Chairman.

SENATOR BINGAMAN. Thank you. Senator Sanford, please proceed.

SENATOR SANFORD. Mr. Chairman, thank you and let me thank the members of the Council for not only being here, but for this work. I think it's going to make a very constructive addition to what we're able to accomplish in the country.

Mr. Regan, I have been fussing about the budget and how sloppy it is ever since I arrived here. You mentioned the capital budget, which, of course, in the states we could handle very well because we had it defined and structured so that any debt had to be paid back that was put in the capital budget.

How would you handle a capital budget, and particularly in the context right now? We do need some infrastructure investment, and it includes a whole lot more than sewer and water in suburbs. It includes, of course, libraries and reconstruction of buildings downtown. It includes, as Mr. Packard pointed out, somewhere between $10 and $15 billion of federal contributions to state and institutional matching funds for the facilities and equipment for science and research in academia that has been neglected so long.

If we wanted to get on with that, how would we get it into a capital budget because, obviously, it seems to me, it's an investment.

MR. REGAN. I think, Senator, that it's too late in the process and too short a timeframe to try to create a capital budget for the United States Government. There are plenty of studies that have been done on it. They're around and I'm sure the chairman of the Budget Committee has looked at it.

SENATOR SANFORD. We've looked at all of those. I was simply raising the question: Would it be possible to have, for accounting purposes, or to assure that we're not running up the debt, a quasi-capital budget for emergency infrastructure investment?

MR. REGAN. I think that you could make an approach somewhat along these lines. Take the projects that are now on the shelf of the 50 governors' offices, you would make them be disciplined a little more in terms of maintenance—as I suggested earlier—to require maintenance if they're going to build them, and to require where they're going to be located.

You can't second-guess every one because the governors ought to be able to make up their own minds. But you would take them. They're there. Studies have been done. They're on every governor's shelf. The environmental impact statements are completed.

SENATOR SANFORD. That's right.

MR. REGAN. And you would then have them, here is one approach. Then the Treasury could buy the bonds, which the local or state governments would issue at a certain percentage. The rest would, of course, be bought in the public markets and on a lowered or on an interest-free basis. And then you account for that over the life of that foregone interest over the life of the bonds, not like we do today in the Federal Government—if you build a battleship, you write the check. But you would account for it over the life of the bonds.

Now, at that point, you're starting to approach the concept of capital budgeting—paying for something over the life of the project. And you would get both, as our chairman has mentioned, the long-term advantage of rebuilding our infrastructure, and at the same time, you would get a quick shot into the construction area, because these are projects that exist. Every mayor and every governor has got them. You would get an immediate shot in terms of employment, and at the same time, you could define an accounting mechanism—and I think a legitimate one—that would not impact the deficit the way you presently do it.

Now, that's a plan. By the way, that's been put forward by a group that I'm associated with, as is Senator Moynihan. We sat and did it, and also Jim Tobin from Yale, and others.

SENATOR SANFORD. I've drawn some legislation to do that.

MR. REGAN. We have a detailed report.

SENATOR SANFORD. I'd like to talk to you more about it when we have more time.

MR. REGAN. Fine.

SENATOR SANFORD. I thank you. I think it's one way that we can boost the economy and not add to the debt.

MR. REGAN. We think it can be done.

SENATOR SANFORD. Yes. Thank you very much. Unfortunately, these hearings don't give us much time to ask questions, but I think it has a lot of promise, and I'll be back with you, if I may.

I'd like to especially welcome Mr. Araskog, a long-time friend of mine. I appreciate so much the chance to see him. I'd like to ask you a question about our preoccupation with all the short-term goals that we have in the corporate world. There's been a good deal of comment about it in this report, that we focus so much on quarterly results and reports, and that we don't get around to the more patient, long-run research and management production goals.

How do we get more patient capital? How do we encourage investments that reward long-term strategies?

MR. ARASKOG. Well, Senator, I started this on the basis that I really thought we had to change our dividend taxation policy—our investment tax credits—and that we especially have to address the business of job creation.

One thing we don't have in this report—and you as a lawyer will appreciate it—we did not list a litigious society as one of the areas we wanted to address.

We did that on purpose because that is the focus of Vice President Quayle's organization, which is also looking at competitiveness. But believe me, that is a significant problem for U.S. industry because of the cost we have to build into every product and because of tort and product liability.

SENATOR SANFORD. Yes.

MR. ARASKOG. And we know that all of you down here are addressing that issue and, hopefully, in the course of the next year or so, we'll get a major correction there that will help our long-term strategy and our long-term position.

Finally, as you well know, companies are different. Some companies have had and do have today the opportunity to plan for the longterm, and they do it.

I made a comment early in the meeting that I thought we had to get more of the management of our public corporations out of Wall Street and back where it belongs, in their company headquarters. I think a lot of companies have been able to accomplish that and those that have been able to address the long-term. But I think, as Dr. Bergsten has pointed out, that's the exception, not the rule.

MR. BERGSTEN. Senator, could I just add two things.

As Ned Regan said earlier, one of the things his subcouncil on corporate governance and financial markets is going to be addressing is whether the current structure of our financial markets push corporate management in the direction of short-termism. And there's a lot of evidence to that. They're going to try to come to grips with it and make proposals.

But there's a second dimension that's often ignored. And we put a box on page 12 of our report to flag it. The fact that the U.S. economy has performed worse than our major competitors over the last decade or so and is much more volatile than our major competitors does make it hard for corporate management to think longterm. Our growth rate has been much more variable. Our inflation rate has been much more variable. Our interest rates have been much more variable. Our exchange rate has gotten way out of whack.

When you compare the volatility of these fundamental results of the economy to Germany or Japan—as the study we referenced did—you find an environment that does make it much harder for American management to think and act longterm.

That's not to absolve them, and we're saying, sure, there are some things that need to be done there, too. But the environment is not a very hospitable one, and it comes back to this need for a holistic kind of comprehensive strategic approach where all elements, ranging from the macro down to the firm-specific management, are looked at comprehensively.

SENATOR SANFORD. Well, we're going to look forward to continuing advice from you. My time is up. I'm sorry. I have got to go, Mr. Chairman, to a meeting of the North Carolina delegation to promote investment in scientific facilities.

Thank you for being here.

SENATOR BINGAMAN. Senator Sarbanes, please proceed.

OPENING STATEMENT OF SENATOR SARBANES

SENATOR SARBANES. Thank you very much, Mr. Chairman.

First of all, I want to join my colleagues in commending you for holding this hearing, and the Competitiveness Policy Council for the report that we are hearing today. It is the direct result of the provision that you put in the Omnibus Trade and Competitiveness Act.

All of this is the fruit of this idea that you had.

The first question I want to put to Mr. Bergsten is, what happened to market ideology? I do not want to indicate my own particular position, but I am sure that some are going to be absolutely shocked by these proposals to have a competitiveness strategy through both sector-specific and generic policies. Then we are going to assess the likely course of key American industries, act as an ombudsman within the Federal Government for specific competitiveness issues, and respond intelligently to proposals for assistance from specific industries.

I thought that we operated with a market dogma and the market determined everything. Does this Council not agree with that?

MR. BERGSTEN. Senator, we obviously talked about that long and hard, and we don't think anyone should be shocked by our proposals. We make the fundamental point that the United States has always had, will always have, and does today have a panoply of policies aimed at specific sectors.

SENATOR SARBANES. What about our competitors? What do they have? They have developed it to a fine art, haven't they?

MR. BERGSTEN. Well, you skipped only one step in my logic. You are two steps ahead of me, as usual.

The issue to us is whether the United States does it effectively and intelligently or reactively and poorly.

And what we find is that in a number of historical cases where the United State has gone at it in a systematic and thoughtful way in agriculture, commercial aircraft and computers under the defense or space rubrics, we've had, and the report uses these words, spectacular successes.

However, in most cases, we go at it ad hoc, episodically, reactively, and therefore, not very effectively. Then come our competitors, who tend to do it more systematically. They don't always get it right, either. The famous MITI guidance has picked some bad losers and has ignored some big winners. So, one shouldn't overstate it in Japan or anywhere else.

But the issue to us is not whether you do it, it's whether you do it sensibly. And what we're saying is that the U.S. Government, and we would include the Congress, but focusing here on the Executive Branch—has no mechanism to do it thoughtfully. And therefore, we say explicitly, let's at least have baselines so that we can see where key industries are going. Compare that with what our vision would be for a prosperous and competitive economy. Keep an eye on what the foreign competition is doing.

I wouldn't use pejorative or taboo terms to define any of that. I simply say that that's a sensible, pragmatic policy. And our Council believes that that needs to be part of any comprehensive American effort.

SENATOR SARBANES. My perception is that it used to be the American genius that we were pragmatic and that the Europeans and others were all tied up in dogma. That seems to have completely reversed itself. They seem to be very pragmatic, and we seem to be operating off of dogma.

The Chairman held a hearing just last week on what is happening in the aerospace sector. That is our biggest producer of export earnings by far. The Europeans, of course, have underwritten Airbus to an incredible degree, and it really has the potential obviously of jeopardizing the American aerospace industry—it has already put McDonnell-Douglas in a difficult position and may do the same thing to Boeing.

Let me ask you this question. We have a lot of workers who make tanks. We obviously do not need as many tanks any more, thankfully, and we ought to regard that as a great opportunity.

We do not make any subway cars in this country. We import all of the subway cars, whether from Italy, Canada, France or Japan. We obviously need to build mass transit systems. We are in the course of doing that now. Urban areas that do not have them are trying to get them. Urban areas that do have them are trying to expand and upgrade.

There are good transportation reasons for doing it, environmental reasons for doing it, and energy reasons for doing it.

So as far as you can see into the future, we are going to need subway cars for new systems and to replace old systems.

Now, surely we have the capability to produce first-class subway cars. How do we do that?

MR. BERGSTEN. That's a very good question, Senator. Neither I, personally, nor the commission, I think, probably has an answer.

If you start from the point of producing fewer tanks, we do say repeatedly in the report—I mentioned it before briefly—that the military build-down does provide an enormous opportunity in terms of the coming availability of human and fiscal resources.

Senator Sarbanes. That is on page 30, where you talk about DARPA. Do we need a civilian equivalent to DARPA that makes the decision that there is a civilian technology that is in great need. We have the capacity to do it. The private sector is not going to produce these defense airplanes if the defense department did not give them a contract to produce them.

Mr. Bergsten. At the head of our section on technology, under Framework for Action and possible new steps—page 30—we do suggest the possibility—what we call euphemistically—a new mechanism for government and industry to work together toward the development of precompetitive technologies. A lot of things that you're mentioning would come under that heading.There is an idea called a civilian technology corporation—some would label it a civilian DARPA—which could very importantly play this kind of role. And indeed, similar defense department programs played such a role in the past, as you say.

Our emphasis here is on the need to find improved ways to comercialize inventions and basic technology that is still invented here. This is not a firm recommendation from the group, but we're now going to look at developing a firm recommendation—that this is one possible way to go. There will be other ideas emerging from other groups within literally the next few weeks—blueprints for a civilian technology corporation that could play the kind of role you talk about.

I'm not sure it could go to the final level of the product. It may be that one has to leave that to the market and to private companies to respond to. But in terms of setting standards, developing rail systems that provide the infrastructure on which then U.S. production could meet the demand for the specific product, that is the kind of thing where we feel a government role is not only appropriate, but has been done in the past and may even be necessary.

Senator Sarbanes. It is not clear to me that in those instances in which the infrastructure is a heavy public investment, like inner-city rail and mass transit, you ought not carry it one step further and see it as an opportunity for domestic production of the equipment that rides on those rails.

It seems to me that you are probably going to need some government help at least to get started, since the others are already there. They have made the development. They have incurred the development costs and everything. They are rolling these things out at the end of a factory line. We do not even have a factory line that is producing them.

I want to ask you this question. When you talk about increased savings, you are talking about the savings of the society that embraces both the public and private sector.

Is that not correct?

Mr. Bergsten. Right.

Senator Sarbanes. I ask that question because there is a great tendency to think of it in terms of private savings only. Therefore, to come in with various tax schemes or other schemes to encourage private savings that, in fact, increase the deficit, and sometimes increase the public deficit by more than you pick up in private savings, when that happens, you have simply worsened the savings situation.

Is that not correct?

MR. BERGSTEN. That's correct. That underlays, of course, my response to Senator Specter on his specific proposal.

In the report, we come down hard and fast on not only eliminating the budget deficit, but trying to move it into a surplus for exactly the reason you say. We do observe that, historically, prior to the 1980s, there was an inverse relationship all through our history between public and private savings. The national saving level, or the national debt, which is the flip side of it, remained in a very constant range really through the whole history of the republic. When public saving went up, private saving went down, and vice versa.

In the 1980s, all that changed. Public and private savings both collapsed. And so the national debt went up from the traditional range of 140-150 percent to almost 200 percent. And the national savings rate collapsed to the lowest level in recorded history.

So, we're exactly with you on that and, indeed, like most economists, we find it hard to say what measures would really promote private saving on net for the country. We, therefore, say the first and foremost task in getting the national savings rate up is to get rid of the public dissaving through eliminating the budget deficit. Indeed, convert it into a budget surplus—despite Senator Sasser's caveat on how hard that is to do—move it into a surplus in order to make a net contribution to national saving and therefore to the economy as a whole.

That is something we came down hard and fast on, and our responses to specific proposals like Senator Specter's will, I suspect, always be driven, in large part, by that.

SENATOR SARBANES. My time is up.

MR. REGAN. May I, Senator, just briefly. We do have a market economy and my guess is that if the private sector saw that the Federal Government, and let's also say state governments, had a policy of infrastructure investment—and you know it's been declining over the years, not growing—and then had an urban policy that promoted urban growth and urban living, part and parcel of which would be mass transit lines, that if that were the feeling in this country, as it is in European countries, as it is in some other Asian countries, that the private sector would move right in, and we'd get our subway car plant.

My guess is that people don't want to raise the capital for that and people don't want to gamble on it because they're just unsure of the commitment because rail lines have to be subsidized—they are the world over—they're unsure of the commitment of the Federal Government to urban living and urban life, and they're unsure of the commitment of the Federal Government to public infrastructure.

Both have been weak, and there is no reason why anybody is going to invest in that environment.

SENATOR SARBANES. I think that is a very good comment. The only problem I have with it is that it still does not get us over the threshold, as I perceive it, because these other countries are far ahead of us on their commitment to mass transit and to inner-city rail. Therefore, they are far ahead of us on producing the equipment that goes on those tracks.

It is difficult for me to see how we get from no production to production in a competitive way unless, somehow, there is a government policy that gets us into that line of work, because the others have already done all of their start-up costs and everything else, and they are ready to come in with these cars and compete and submit the low bids and so forth.

MR. REGAN. Los Angeles.

SENATOR SARBANES. Yes.

SENATOR BINGAMAN. Senator Dodd, please proceed.

OPENING STATEMENT OF SENATOR DODD

SENATOR DODD. Thank you very much, Mr. Chairman. I'd ask unanimous consent that my opening comments be included in the record, and join with our colleagues in commending you for your work.

Let me, at the outset, say to Ned and the others that I accepted and then had to reneg on an invitation to join with one of the subcouncils or subcommittees here on corporate governance. I discovered that the subcommittee would have to report to my full Committee or to my Subcommittee on this Committee, which created a bit of an awkward situation. So, I had to retreat from serving on one of the subcommittees dealing with these issues. But I'm very much interested in what you're doing, appreciate the invitation, and look forward to working with you on some of these questions.

I want to pick up on what Senator Sarbanes was moving on here a little bit, and I'll come back to some questions on corporate governance, because I'm particularly interested in shareholder issues, and institutional investors, and some of those questions that have to be raised.

It occurs to me that on this downsizing or peace dividend that everyone's talking about, in a sense, what we need to be doing is thinking about some middle ground in terms of investment.

It was a remarkable accomplishment that for four decades that this country was able to invest in the development of modern technologies, which maybe saw their fruition or their most successful days, I suppose, in the actual usage in Desert Storm, to some degree.

It worked. This technology that designers and engineers and pipefitters and welders built over the years really worked, and we made a substantial investment in it, because we decided that it was in our national interest to do so.

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Today, we're talking about taking that dividend and moving it to the other side of the budget and investing it in health, education, welfare and these other issues that are clearly important.

Why not, in a sense, take that same mentality that produced, in effect, this incredible engine of national security and invest, if you will, in the things that we now know that we need?

Senator Sarbanes talked about mass transit, environmental technologies and communications, something you, Mr. Araskog, would appreciate immensely. You go down a long list of those kinds of investments that we need to be making along the same lines.

You're not going to get private capital, for instance, to be terribly attracted to investing in one of these supersonic airplanes that may cross the Pacific in an hour and a half. The Japanese are investing $200 million in that program because they know that there's no commercial application of that technology in the near-term. But they understand that by the year 2025 or so, there will be a clear commercial advantage to that investment.

So, instead of talking about defense dollars being transferred to the other ledger, if you will, or the other column in the budget, why not be doing, in effect, what we did for four decades and invest in those things that have also, by the way, occurred or created tremendous spin-off technologies—the NASA and defense budgets. How much of commercial technologies emerged as a result of our federal commitment to a national security budget?

What I'm trying to get at here is some sort of a middle ground of investment. Instead of just moving the dollar over to the entitlement program, if you will, or whatever else that may have occurred in the nondefense-related areas, why not be making the investments that you cannot get private capital to invest in so that we begin to do those things that are absolutely critical for our economic success in the 21st century?

[The written opening statement of Senator Dodd follows:]

WRITTEN OPENING STATEMENT OF SENATOR DODD

Mr. Chairman, let me commend you for your leadership on this issue. Back in 1988 when you offered this as an amendment to the Trade bill, our Nation's competitiveness was often discussed, but few had found ways to bridge the gap between words and action. Today's report by the Council is a major step forward in defining the broad range of issues involved in competitiveness, and sketching a blueprint to address them. It is a tribute to your foresight that we have traveled this far.

Nor could today's hearing come at a better time. We are in the middle of the worst downturn since the Great Depression, and people are hurting.

I was not alive during the 1930s, but the fear and desperation I see on people's faces in Connecticut is right out of photographs from that period. It reminds me of the stories my father told me of his friends and neighbors who had lost all hope in the face of such daunting troubles.

People these days want to know two things. First, they want to know if you get it. They want to know whether or not their elected officials understand the pain and the hurt and the suffering they're going through.

Second, they want to know what you're doing to help them. The ideas don't have to be original or creative. But they have to offer hope to people who desperately need it.

Today's report makes clear that some of our current problems are cyclical, and will end when the recession finally does. But it also outlines the fundamental structural weaknesses eating away at our Nation. In that sense, today's report should be a wake-up call that we need to reorder our priorities and squarely face the challenges of the 1990s and beyond:

- We as a Nation do need to save more, and we should be investing more in commercial, transportation and educational infrastructure.
- We must improve our educational system, particularly at the elementary and secondary levels.
- We need to do a better job of turning research into the development of new products.
- We need to look closely at corporate governance and the role it plays in our economic competitiveness.
- We must reform our health-care system, which eats up an ever-increasing amount of our gross national product, yet leaves 34 million Americans with nowhere to turn if they get sick.
- We need to dismantle both foreign and domestic barriers constraining the growth of U.S. exports.

The Council's general recommendations in these areas are all constructive suggestions. And I believe that together, they offer some hope for the future. Putting a plan on paper, as the Council has, enables us to see the light at the end of the tunnel. It's also a welcome break from past discussions of competitiveness, which has been long on self-flagellation, and short on blueprints for change.

But it's also just the beginning. I look forward to the hard work needed to translate the Council's recommendations into law. Addressing the budget deficit, for example, will require everyone to put ideology aside in the search for a compromise that equitably distributes some very real pain. And the other recommendations are by no means easier nuts to crack.

Still, the Council's report is fundamentally hopeful because it recognizes that our problems aren't insurmountable. If we roll up our sleeves and go to work, we can make headway. We're Americans, and so we're used to doing that. I congratulate the Council on a fine first effort, and I look forward to working with them to build a more competitive America.

Mr. Araskog. I think it's a great idea. I think the big danger is that what's saved in defense will not go into the capital structure of the country. It will go over into entitlement programs.

That's really your area. But to Ned's point earlier about our infrastructure, which does create jobs, which does need fixing, some method of going from a Department of Defense budget, which concentrates on R&D and not so much on long-range production programs—as Secretary Cheney has described it—and focus on the area that you've described, it seems to me is part of what this is all about, and the right way to go.

Personally, I think so, and I think within the study that that's one of the areas that we have to look at.

As far as just transferring technology from the defense area to the civilian area, I think just about anyone who's been heavily involved in defense—I think we're the 23rd largest defense contractor right now—there isn't very much that's convertible unless it's something that basically applies to a Boeing product line or a McDonnell-Douglas product line to begin with—a collision avoidance system, a radar system. But most of the military applications are strictly military.

Senator Dodd. You're getting a lot of it in some of your electronics and communications systems. NASA had a lot to do with this, and there were probably more direct spin-offs in the NASA budget than in some of the defense, although I don't know that—metals, and new welding technologies. There are a lot of these ideas that you never would have raised, in my view, a private dollar for, or it would have been very difficult to raise them. But we're willing to make the investment in the defense dollar and taking advantage of those investments now, it seems to me, is the issue.

Senator Sarbanes. On that point, what every major airport in the country needs to significantly upgrade is its air traffic control system.

Senator Dodd. That's being done. That's a good example.

Senator Sarbanes. We have people who have been doing radar and air traffic control systems in the defense sector. But we do not have a national commitment to upgrading those civilian air traffic control systems, which could now be put in place and be a significant target for shifting defense production into civilian production.

I think that is a technology that is easily transferrable.

Senator Dodd. That's happening. Norton Industries is an example—a division of United Technologies—they are competing for the use of microwave landing systems which were developed as a result of defense dollars. Today, in a joint venture, I might add, with some operations in the former Soviet Union, which also had excellent development of microwave radar systems, are now competing for the use of those radar systems in commercial airports across the globe, in effect.

So, they are a very good example of where something like that is already happening.

But I wonder if you might comment on this as well, Mr. Bergsten.

MR. BERGSTEN. One of the aspects of the U.S. problem that we focused on most heavily in the report was the decline in our government spending and total national spending for civilian research and development, to develop exactly the kinds of technologies and commercial products you're talking about. We also heavily emphasize the lag in our own manufacturing sector to commercialize technologies of the type that you were identifying.

And there, I would just reiterate what I said a moment ago. We suggested the possibility of a new government corporation that would be run as much like a private corporation as possible, maybe with a multibillion dollar start-up to try to promote more rapid, effective commercialization of technology of exactly the type you're talking about. New institutional mechanisms are probably going to be needed to do that.

SENATOR DODD. I'll come back. I want to get to the corporate governance questions with you, which I know you're interested in as well.

Thank you.

SENATOR BINGAMAN. Let me just advise you, I've been given a note to the effect that there are 25 House members waiting to meet with the Competitiveness Caucus.

So, let me call on Senator Domenici for his questions, and then if there is another burning question, we'll take it. Otherwise, we'll try to adjourn and let you get on to the next thing.

Senator Domenici, please proceed.

OPENING STATEMENT OF SENATOR DOMENICI

SENATOR DOMENICI. Thank you very much, Mr. Chairman.

First, let me say that I apologize for not being able to be here earlier. It wasn't that I had nothing to do. It was other committees. But I did want to come by for a minute.

Let me just share a couple of thoughts and then ask a couple of questions.

First, it seems to me that we have a very strange situation in the United States today. We still have the highest standard of living in the world, and yet, our productivity is not doing very well, our deficit is enormous, our investment capability is very, very much below what it has been at other times, our net savings is bad and our education seems to be not so good.

Which leads me to conclude that the fact that we have such a high standard of living is evidence that we are a very consuming country and we are not doing what is required to keep our growth up.

And if anyone cares to comment, I'd be interested in it.

But what I really am concerned about is that I keep hearing that, with reference to the United States Government versus competitiveness, we ought to—and I'm just going to paraphrase—we do things the way the Japanese do or the way the Germans do, or we ought to finance some parts of our future needs through government in terms of our material well-being and competitiveness.

I guess I'd like to know if you have any examples of what foreign countries are doing in this regard that we shouldn't do. Did you find any? And another reason that it concerns me is that I have heard so much for so long about what MITI did for Japan's business, and then when I got another version of it from somebody that knew it, they weren't doing anything like we were saying they were doing in the United States.

So, I don't know how relevant what other countries are doing is to what we ought to be doing in terms of investing public money in trying to get ahead on the competitiveness side in unordinary ways. I don't mean in education.

Could you share that with me just for a moment?

MR. BERGSTEN. Well, there is a raging debate on that—as you imply—as to how important the role of MITI or government investment has been in general in Japan—so-called targeting, so-called industry visions.

We certainly do not recommend any wholesale emulation of what other countries are doing. We do say that in specific areas programs in other countries look like they could be helpful here.

Now, in education, some of the apprenticeship programs in Germany and other European countries do look like they might be worth taking on.

When we talk about a forward look at where our industries are going, visions of what the outlook is, we are consciously drawing on not just what Japan but on what most other countries do, because they do try to assess both the composition and aggregate outlook for their economies.

But we don't have anything in here about what, I guess, you're calling extraordinary spending. We do observe that as public infrastructure spending by the U.S. Government itself has been cut in half over the last 20 years, our productivity has dropped sharply, and there are some very persuasive correlations between those two.

We had a long session on that at the commission—a range of economists—but they all agree it's important.

So, we've been eclectic in trying to select from other countries' experiences. Nothing wholesale. But let's learn where we can. Certainly, others are doing better in key respects.

SENATOR DOMENICI. My last question on that is that there's a suggestion that we ought to centralize more and focus on the competitiveness activities of the government, either in an agency or a subagency within Commerce.

In making that suggestion, did you review what we are currently doing, even though it is not within one agency? I look over the kinds of things that we're doing, and it amazes me that people are suggesting that we do some things and we're already doing some of them.

Supercomputing—we have a great program—just a whole list. But they're not under one jurisdiction. If any, they're in the Department of Energy, which is kind of amazing, but that's——

MR. BERGSTEN. Well, they are scattered all over, as Senator Bingaman pointed out earlier. And one question is whether some better central view of them would be desirable.

But I think our feeling goes a little beyond that, that many of the things that are being done are not being done very well. And one reason that they're not done very well is because there's no policy focus to them. There are the kinds of ideological and other debates that Senator Sarbanes talked about, but you don't really attract the best people to work on those issues if there's a barrier, a sound barrier, to even working on the issues.

I'll draw on my own experience. I've had two fairly high level positions in the government. Whenever an industry came in and asked for help, the U.S. Government, frankly, was not prepared to respond in an intelligent way. It had no independent judgments of where that industry was going. It didn't know what useful steps could be taken. It didn't even know what proposed steps might be harmful. It was naked.

We have the feeling that the time has come to overcome that kind of situation. Put the government in a position to deal effectively and intelligently with issues of that type that are going to come. You can't wish them away. They're going to come. We have to deal with them more effectively.

So, it's not whether we do it or not. It's whether we do it well, and that's what our group is trying to recommend.

SENATOR DOMENICI. Thank you, Mr. Chairman.

SENATOR BINGAMAN. Senator Riegle had an issue he wanted to raise, and then SENATOR DODD.

SENATOR RIEGLE. I'll be very brief because I know you're due on the House side and that some of your members have gone across.

As opposed to taking defense production plants and trying to do a defense civilian conversion, which is difficult—and you talked, Mr. Araskog, with Senator Sarbanes about that—I'd like you to move up a level, in terms of our defense research and development laboratories, many of which are in areas of the budget where they're screened off so that the kind of esoteric research of one kind of another that has gone on, with respect to weapons systems and various things, are things that most of us in the Congress don't even have a working knowledge of.

We spend a lot of money in that area. We spend tens of billions of dollars a year in those government research and development laboratories.

It seems to me, entirely consistent with what you're suggesting, is that if we could take that government research and development laboratory effort and manage an orderly shift of part of that out of the defense areas, which are now being deemphasized, over into civilian research and development activity, we could hold some of these seams together. We could, in fact, manage an orderly transition and accelerate our way into the kind of policy requirements that we're going to have that's coming out of your basic work. And one way to do it might be as follows.

Let's say we decided that over the next 3 years, we would take, say, $20 billion of Federal Government spending in these research and development defense laboratories and shift that over to civilian research and development, to be matched by, say, $20 billion from the private sector.

The question would then arise, well, where do you aim it? What do you go out and look at, or where do you apply that scientific talent?

And I'd like to suggest three areas, just as a way to get you thinking about it. I've talked to Lester Thurow and others about this, who have given this some thought.

One might be microelectronics. This is a broad category. This isn't industry-specific or company-specific, certainly. Another might be biotechnology. Another might be advanced materials technology.

Now, these are all three broad sectors that the Japanese have targeted as sectors for the future, that the Germans and the Europeans are targeting as sectors for the future, and clearly are, from our point of view, areas in which we want to be, I think, competitive and, hopefully, state of the art.

We're spending very little money in those areas today, I think, relative to what we need to. But if we could envision a partnership where that tremendous applied public-sector focus of talent and technical capability has been amassed and is now working, and bring that over into a limited number of very wisely chosen broad areas of endeavor so that we could keep those teams together, and then move that into civilian kinds of research, which can, in turn, be available generally to our industry, our manufacturing and so forth.

It seems to me something like that, now that we're at this historic moment at the end of the Cold War, is the kind of intelligent transition that, in effect, could accomplish your goals without getting bogged down in this business of picking "winners or losers", or an intervention on behalf of a specific company.

And I'd like to suggest that you look at that. I don't ask you, now, necessarily under the pressure of time, to respond to it, unless you feel motivated to do so. But I think it's possible that we could take and make that kind of a redirection if it were matched by the private sector in some amount over some timeframe, and rather than have these world class scientific teams just blown every which way, to keep them intact and move them over and get them underpinning the kind of advanced development in our civilian economy that we need to have if we're going to get out front and hope to stay out front in the world economy.

Mr. Bergsten. Mr. Chairman, three quick responses.

First, we clearly share your goals. Second, we will look at that proposal. Third, two things to keep separate in one's mind. One is basic research. When you talk about the national labs, you're talking about basic research at the invention side. That we clearly do want to see augmented in the way you say.

The second, and we focus on this, is the commercialization of technology, and that's where we think some kind of new civilian technology corporation—call it a civilian DARPA—may help us move from that basic invention level to the market place where a lot of the failure has been.

So, we may need to do both, reconversion of the labs and a new operation to try to help speed the commercialization process. We'll look at both. We'll certainly look at your idea. I think it's a very creative one.

SENATOR BINGAMAN. Senator Dodd?

SENATOR DODD. Just very quickly, and I guess we could have spent the whole morning on just the corporate governance is-sues, but I just wanted to raise a couple of points. And Al, maybe I'd raise these with you, if I could, to start with.

And that is this whole notion of labor wearing two hats. You have this whole question of being employees, but being owners—creating a whole new dynamic, it seems to me.

I recently went through a plant in Connecticut—Alleghany Loveland—a very good steel manufacturing operation organized by steelworkers. I'm not exaggerating when I tell you about going through that facility, when I was introduced to the plant manager and the president of the local union, there were about ten other people around and I couldn't figure out during the entire tour which one was actually the plant manager and which one was the president of the local.

There were about 12 people there and I just got confused. But their message was so similar, that I could not detect during the conversation which was labor and which was management.

I said to them afterwards, "Well, the enemy isn't in here. It's outside, in a sense." But the whole notion of employee as owner through pension plans and the like creates a new set of burdens.

I wonder if you might just comment briefly on how labor will manage to handle these switching hat roles of employee and owner.

MR. REGAN. Well, Senator——

SENATOR DODD. I mentioned Al, but——

MR. REGAN. Oh, I'm sorry.

On our subcouncil, we will have several of the nation's experts. There are not many. I think we have them on the Council, or testifying, or both.

The figures are now that close to 15 percent of the workers, not through pension plans, but through ESOPs, 401(k)s and individually, 15 percent of the publicly traded stock in U.S. corporations is in the hands of workers, not through their pension plans. That's the first fact.

It's a growing phenomenon. The person that has traced it is a member; has written a book on it; is a friend of mine and is a member of my subcouncil and will deal with it instantly. His name is Joseph Glazie.

Second fact is that there are some pretty good studies that show that if you invest in stocks of companies that have a large percent of their stock in the hands of their workers, you will outperform the market. And there are stock pickers that look at, as a major indicia before they buy, the percentage of stock in the hands of the workers and have devised a basket—I don't want to use that phrase—but a group of stocks with that large a percentage of worker ownership and it outperforms the S&P 500 consistently.

So, we'll look at those issues very clearly and then, obviously, the one you raised inferentially is that, of course—as Peter Drucker said 15 years ago—we're a socialist country. The workers own the plants through their pension systems.

Well, that's a nice phrase and it starts you down the road into thinking. It doesn't really lay out because of the way we run our pension systems and the way the stock is voted, and perhaps it never should.

But there are those issues, and subject to the advice I get, especially from Mr. Shanker, we'll look at it and follow up, and we'll try to do something very closely with your work.

MR. SHANKER. Well, Senator, you raise the tensions that take place in this sort of situation. You're absolutely right. It's interesting that probably, in most cases where this has occurred, there are situations where labor and management are forced to cooperate because of the external enemy, because they're going to go down together and they're forced into that kind of situation.

But here, again, there are examples outside the country. If you look at Germany, there was a form of this type of cooperation going back many years, but it occurs there in an atmosphere which is a lot less cutthroat and adversarial than the American labor management scene has traditionally been.

I say that at various labor meetings. We discuss those tensions quite a bit because inside of all of those unions, which are either involved in such relationships or are thinking of being involved, there are political sides being taken by people inside the union; those who feel that it would be the salvation of the industry and the union to cooperate and develop this sort of relationship, and those who feel that it's the end of real unionism, and that when you get involved in that cooperation, that you're not really going to get so interested in what the company side of it is; that you're really going to forget to represent the membership.

And I think this is one of the things that we need to look at. I think one of the real problems here is maintaining it. You have some of this cooperation; you've had it off and on in the auto industry. I'm sure that the next time there's some sort of session, where we get together and get a chance to talk to OMB, we're going to find that all sorts of areas of cooperation would develop with General Motors and all of a sudden come these announcements, which would be unthinkable in Germany, when you develop fairly widespread cooperation, and inside your own union you are willing to take on opposition and get into quite a conflict in order to develop the cooperation, to then get that sort of a hit from the other side.

SENATOR DODD. Let me mention just one last thing, if I can, Mr. Chairman, and that is something that relates to it. I mention the issue of pensions, because, I guess, I was trying to get two questions into one.

That goes back to the issue of managers and shareholders. There's one line on page 31 or 32 of your report. It says, "the degree to which long-term peformance is the shared goal of both corporate managers and shareholder owners."

Obviously, that suggests that there's not a shared goal here between shareholders and corporate managers. Mr. Araskog, you've spent a lot of time talking about this issue in the past. I've read a lot of things that you've said about it, in terms of the tension between corporate management and shareholders, shareholders looking for the shorter term return obviously on their investment and arguing that managers are more interested in long-term performance.

I had dinner a few weeks ago with Carl Icahn, who sounded like he ought to be working for Ralph Nader, in a sense. He just railed for about 45 minutes against corporate management. And he considers it in many ways to be the single most serious problem in terms of our competitiveness—the incestuousness of boards of directors and management, and he went on and on. You've heard him on this subject in the past.

It was quite a meal to hear him go on and on. Obviously, he was a corporate raider. He had a different perspective. But I wonder if you might just quickly——

SENATOR BINGAMAN. Could you do that quickly? We're getting a real panic going on the House side with the length of time we've kept you folks.

MR. ARASKOG. I've been on a panel with Carl Icahn. I just look at TWA. I mean, management? He never heard of it.

[Laughter.]

SENATOR DODD. I think we'll have to carry this conversation on.

[Laughter.]

SENATOR BINGAMAN. Let me thank the panel very much. We've kept you very long and we appreciate it. I think this is an indication of the extent of the interest here, which is the main purpose for your being in existence.

So thank you again.

MR. BERGSTEN. Thank you, Mr. Chairman. We look forward to much more of the same.

SENATOR BINGAMAN. Thank you.

[Whereupon, at 12:25 p.m., the Committees adjourned, subject to the call of the Chair.]

[Responses to questions posed by Senator Riegle, Jr. to Mr. Bergsten follow:]

Senator Donald W. Riegle, Jr.
Questions for the Record
of the Hearing on the
Report of the Competitiveness Policy Council
March 4, 1992

Debt-financed growth

Q.1. Page one of your report states that much of the economic growth experienced by the United States in the 1980's "was financed by borrowing from our own future, both at home and from the rest of the world." Can you elaborate on what this borrowing, especially our huge international borrowing, was used for and what this portends for the future standard of living of our citizens?

Industry-specific policies

Q.2. You conclude that we need sector-specific competitiveness policies, as well as generic policies. The legislation establishing the CPC calls for industry-specific analyses. I realize that you have just begun work and that industry-specific analyses would be a large undertaking. Do you plan to issue future reports with industry-specific analyses?

Q.3. Your report states that "it is important that the United States enhance its position as an exporter of products based on high levels of skill and high value added, i.e., manufactures that can support high wages", and that "the United States takes no systematic view of the composition of its economy, except with respect to military production, while many other nations emphasize structure as well as aggregate outcomes." Could you please elaborate on some of the approaches and practices of the EC countries and Japan in this respect?

Capital formation and tax policy

Q.4. As you know, the Congress is working on a tax bill to help the economy. I view that bill as a short-term remedy, at best. Much needs to be done. You are establishing a subcouncil to look at the question of capital formation and savings and investment. Do you think we need a complete overhaul of the tax code to promote investment? If so, will the Council formulate proposals to do that?

Public investment

Q.5. Many people are talking about how to improve public investment. We may now have an opportunity to do so with the "peace dividend". Do you believe we should spend the "peace dividend" on public investment? If so, what rules should we use to guide us?

Trade policies

Q.6. You state that one of our goals should be the elimination of the current account deficit by 1995. How do you propose doing this? If you don't yet have specifics, do you have some general guidelines of how we should approach that goal? For example, do we need tougher trade policies built on reciprocity?

Q.7. Among the set of recommendations made by the Council for dealing with our trade problems is a call for a "comprehensive assessment of how multinational corporations, particularly those headquartered domestically, affect our competitiveness." Can you elaborate on that proposal? Are you suggesting that we need to understand better whether foreign transplant companies that make autos, for example, may be adding to our trade deficit by the way they import components for assembly here?

Health care

Q.8. You rightly point out that health care costs are an important factor in our competitiveness. In 1990 the average cost for health care for the Big 3 American companies was about $1100 per car. This well exceeds our competitors by over $500 per car. In your report you mention various proposals to solve our health care problem. Do you have any thoughts about any of those plans -- especially in light of the fact that you are not establishing a subcouncil on health care?

Government structure

Q.9. Your report also observes that "America's future will increasingly depend on our economic prowess rather than our military capability." Does the Council believe that U.S. economic security is fundamental to our national security? Could your elaborate on the linkage between economic and national security?

Q.10. In your report, you note that the United States is now part of a global economy but that our present government structure is not designed to help this country compete in such an economy. Your report suggested that the U.S. Government needs to designate a lead agency, such as a substantially strengthened Department of Commerce, to take the lead in developing a coherent competitiveness strategy. Do you think a better approach might be to create a National Economic Security Council chaired by the President to help develop and pursue a coherent competitiveness strategy, just as we created the National Security Council after WWII to coordinate our political-military efforts during the Cold War?

Technology transfer

Q.11. With respect to the issue of technology, does the transfer of U.S. technology to foreign entities raise any concerns for U.S. competitiveness? Will the Council be addressing the effect of international technology transfer? Will the Council be evaluating the impact on U.S. competitiveness of the transfer of sophisticated manufacturing processes to foreign firms as well as the transfer to overseas facilities of the production of goods or components requiring special technical skills and training?

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QUESTION: Page one of your report states that much of the economic growth experienced by the United States in the 1980's "was financed by borrowing from our own future, both at home and from the rest of the world." Can you elaborate on what the borrowing, especially our huge international borrowing, was used for and what this portends for the future standard of living of our citizens?

ANSWER: Our borrowing in the 1980's enabled us to spend beyond our means -- in both the public and private sectors. Some of this spending undoubtedly went for productive investment but most of it went into consumption. Some went toward unproductive investment like many of the office buildings that currently lie vacant around the country. It is clear that it did not go into increasing investment -- the rate of investment as a percentage of GDP was flat at an average of 17 percent throughout the decade. This record of high borrowing -- when not used to increase productive investment -- places a heavy dual burden on future generations: large debts to be serviced with little means to do so.

Industry-specific policies

QUESTION: You conclude that we need sector-specific competitiveness policies, as well as generic policies. The legislation establishing the Competitiveness Policy Council calls for industry-specific analyses. I realize that you have just begun work and that industry-specific analyses would be a large undertaking. Do you plan to issue future reports with industry-specific analyses?

ANSWER: The Council is establishing eight subcouncils to develop policy recommendations on a broad array of issues relating to US Competitiveness. Many of these issues -- including capital formation, corporate governance, trade and training -- have a direct impact on specific industries. In addition, we are setting up subcouncils on manufacturing and critical technology which will look at competitiveness issues across industries and within specific industries. The manufacturing group is charged with identifying the best way to address these industry-specific issues, including the questions to be asked, the appropriate forum in which to hold theses discussions and the relevant participants.

QUESTION: Your report states that "it is important that the United States enhance its position as an exporter of products based on high levels of skill and high value added, i.e., manufactures that can support high wages", and that "the United States takes no

systematic view of the composition of its economy, except with respect to military production, while many other nations emphasize structure as well as aggregate outcomes." Could you please elaborate on some of the approaches and practices of the EC countries and Japan in this respect?

ANSWER: A coordinated use of government investment in R&D, discrete trade policy actions and other forms of industry assistance in many European countries and Japan have encouraged industrial development toward high-skill, high value-added industries. These steps are usually the result of some understanding of the long-run potential for certain industries, including their contribution to other industries and the economy as a whole. In this regard, our group suggests that there is a need to realize the "importance" of a given industry, both in terms of its strategic importance to the overall industrial structure of the economy, as well as its ability to support high-wage, high-skilled jobs. This is an area which will be fully explored by the Manufacturing subcouncil, chaired by Ruben Mettler, former Chairman and CEO of TRW, Inc.

Capital formation and tax policy

QUESTION: As you know, the Congress is working on a tax bill to help the economy. I view that bill as a short-term remedy, at best. Much needs to be done. You are establishing a subcouncil to

look at the question of capital formation and savings and investments. Do you think we need a complete overhaul of the tax code to promote investment? If so, will the Council formulate proposals to do that?

ANSWER: The Council states in our First Annual Report, "America's low levels of saving and investment are clearly a major problem... The United States has the lowest rates of saving and investment of any industrial country....The foundation of any serious effort by the United States to improve its competitiveness must be a substantial rise in the national levels of investment and saving." Toward that goal, the Council calls for the conversion of the Federal budget deficit into surplus.

In addition to "an intensive review of all major spending programs," the Council also suggests that "it might be necessary to change the structure of US tax policy in ways that would eliminate, or even reverse, the perverse incentives in the present code. The most extreme option would be to substitute consumption-based taxes for all or some of our present income-based taxes." This should result in a substantial increase in saving and a fall in the cost of capital. Additional illustrative examples of suggested tax reforms listed in the report include exempting all interest and dividend earnings from taxation, a value-added tax (VAT), a national sales tax, and a limitation of the tax preference for home mortgages that now applies up to $1 million, or other sector-specific approaches. The Capital Formation Subcouncil, chaired by Peter G. Peterson, Chairman of The Blackstone Group, will look at all of these suggestions, as well as others.

Public investment

QUESTION: Many people are talking about how to improve public investment. We may now have an opportunity to do so with the "peace dividend". Do you believe we should spend the "peace dividend" on public investment? If so, what rules should we use to guide us?

ANSWER: The economy currently faces two challenges simultaneously. On the one had, we need to increase our pool of national savings, at all levels: households, businesses, and Federal and state governments. Toward that end, as already mentioned, the Council places a high priority on converting the Federal budget deficit into surplus. Some part of the expected "peace dividend" should go to help meet this objective.

On the other hand, the Council also places a high priority on beginning to increase public and private investment today in areas which will contribute to US competitiveness. There is much evidence to suggest that investment in public infrastructure enhances US productivity, thereby contributing to US competitiveness. In addition, the Council notes in its report that "an acceleration of government spending on needed infrastructure projects would have desirable effects both immediately and over time." It therefore seems that some portion of the anticipated "peace dividend" should also be dedicated to public infrastructure. The Council's subcouncil on Infrastructure, headed by former Governor Gerald Baliles, will study this question and the Capital Formation subcouncil will make recommendations on the broader issue of reducing the budget deficit.

Trade policies

QUESTION: You state that one of our goals should be the elimination of the current account deficit by 1995. How do you propose doing this? If you don't yet have specifics, do you have some general guidelines of how we should approach that goal? For example, do we need tougher trade policies built on reciprocity?

ANSWER: The current account deficit is essentially a macroeconomic problem: it occurs when we as a nation spend more than we produce at home and when we invest more than we save domestically. However we cannot depend on any single trade policy action to eliminate the current account deficit. Instead, we must follow a combination of policies aimed at the fundamentals -- maintaining a "competitive exchange rate," as required of the Treasury Department in the Omnibus Trade and Competitiveness Act of 1988, pursuing coordinated growth policies among our major trading partners to insure a healthy demand for our exports, continuing to aggressively work toward keeping foreign markets open to our goods, removing our own export disincentives which place our products at severe disadvantage in world markets and improving our export promotion policies, including a significant increase in export financing. These policies must be seen as compliments to increased saving and investment, as mentioned above, and improvements in worker training and productivity. The Council's subcouncil on Trade Policy, chaired by John Murphy, CEO of Dresser Industries will focus on these issues.

QUESTION: Among the set of recommendations made by the Council for dealing with our trade problems is a call for a "comprehensive assessment of how multinational corporations particularly those headquartered domestically, affect our competitiveness." Can you elaborate on that proposal? Are you suggesting that we need to understand better whether foreign transplant companies that make autos, for example, may be adding to our trade deficit by the way they import components for assembly here?

ANSWER: There are two major issues regarding multinationals. One is why American corporations move production and hence jobs abroad. The Trade Policy Subcouncil will focus on factors that make production or investment in the United States less attractive such as inadequate infrastructure, or inappropriate skill mix of workers, inefficient government regulations, inadequate export financing and other export supports, and inconsistencies in tax policy. The Subcouncil may also look at practices of foreign multinationals with plants in the United States such as preferences for home country inputs or transfer price techniques that have impact on the US economy.

Health care

QUESTION: You rightly point out that health care costs are an important factor in our competitiveness. In 1990 the average cost for health care for the Big 3 American companies was about $1100 per car. This well exceeds our competitors by over $500 per car. In your report you mention various proposals to solve our health care problem. Do you have any thoughts about any of those plans -- especially in light of the fact that you are not establishing a subcouncil on health care?

ANSWER: The United States currently spends almost twice as much as other industrial countries on health care, and the gap continues to widen. On the other hand, our population ranks about at the average, or even below average, on certain international health indicators. As we state in our report, "while some parts of the population are receiving the best health care in the world, other Americans are receiving care that is inferior to that in many countries." The report goes on to state that high and rising health care costs hurt US competitiveness in two major areas, "by raising the total costs to corporations that pay health care for their workers and retirees, especially for manufacturing industries where these costs fall particularly heavily, and by consuming resources that might be deployed differently."

The Council decided not to set up a subcouncil on health care costs at this juncture in light of the numerous other efforts being conducted on the issue. We will instead take this issue under review at the full Council level and revisit the decision to establish a subcouncil at a later date. We plan to review the health care reforms currently being proposed, paying special attention to how these changes would affect US competitiveness. In order to do this, we will want to look at both the costs associated with individual plans as well as the quality of care being provided.

Government structure

QUESTION: Your report also observes that "America's future will increasingly depend on our economic prowess rather that our military capability." Does the Council believe that U.S. economic security is fundamental to our nation security? Could you elaborate on the linkage between economic and national security?

ANSWER: Although we did not examine national security in any detail, I think it would be fair to say that the Council believes that US economic security is fundamental to our national security. There are several important linkages. First, a competitive high-technology sector may be critical to having the engineering know-how that will be needed to develop weapons and information-gathering systems. In some cases, American industries may also be needed to assure access to critical components. Second, a strong national economy is in many ways a precondition for continuing national security. Countries can be economic powers without being military powers but it is hard to imagine how a country can be a military power without being an economic one. This may be even more critical for the United States given our historic role as a world leader.

QUESTION: In your report, you note that the United States is now part of a global economy but that our present government structure is not designed to help this country compete in such an economy. Your report suggested that the U.S. Government needs to designate a lead agency, such as a substantially strengthened Department of Commerce, to take the lead in developing a coherent competitiveness strategy. Do you think a better approach might be to create a National Economic Security Council chaired by the President to help develop and pursue a coherent Competitiveness strategy, just as we created the National Security Council after World War II to coordinate our political-military efforts during the Cold War?

ANSWER: Our report states, "our present governmental structure was not designed to help this country compete in a global economy... The government needs to designate an agency, perhaps a substantially strengthened Department of Commerce or the International Trade Commission with its functions greatly expanded, that would raise the nation's awareness of the competitiveness problem and initiate and maintain several activities." Given the centrality of government organization to making economic policies which promote US competitiveness, I will set up a special task force to work on this issue. We will invite experts from inside and out of the government bureaucracy to take part in the discussion and we will consider several alternative models, including a National Economic Security Council. I personally believe that any serious competitiveness policy will require a significantly strengthened organizational mechanism, perhaps along these lines.

Technology transfer

QUESTION: With respect to the issue of technology, does the transfer of U.S. technology to foreign entities raise any concerns for U.S. competitiveness? Will the Council be addressing the effect of international technology transfer? Will the Council be evaluating the impact on U.S. competitiveness of the transfer of sophisticated manufacturing processes to foreign firms as well as the transfer to overseas facilities of the production of goods or components requiring special technical skills and training?

ANSWER: Technology transfer could certainly have an effect on US competitiveness. The Council has not yet focused on this issue, but the Critical Technology Subcouncil, among others, may spend some time on this issue. We will also review the findings of other groups that are considering this question.

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