S. HRG. 99-75

REVIEW OF FINDINGS OF THE PRESIDENT'S COMMISSION ON INDUSTRIAL COMPETITIVENESS

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

MARCH 29, 1985

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REVIEW OF FINDINGS OF THE PRESIDENT'S COMMISSION ON INDUSTRIAL COMPETITIVENESS

FRIDAY, MARCH 29, 1985

U.S. SENATE,
SENATE COMMITTEE ON FINANCE,
Washington, DC.

The committee met, pursuant to notice, at 9:33 a.m. in Room SD-215, Dirksen Senate Office Building, Hon. Bob Packwood (chairman) presiding.

Present: Senators Packwood, Chafee, Baucus and Bradley.

Also present: Senator Pete Wilson.

[The press release announcing the hearing, background material on the PCIC report, volume 1— "Global Competition, The New Reality" and Chairman Packwood's and Senator Baucus' prepared statements follow:]

United States Senate

COMMITTEE ON FINANCE
WASHINGTON, DC 20510

Press Release No. 85-007

PRESS RELEASE

FOR IMMEDIATE RELEASE
March 13, 1985

CONTACT: Sam Richardson
(202) 224-4515

PRESIDENT'S COMMISSION ON INDUSTRIAL COMPETITIVENESS REPORT TO BE REVIEWED BY COMMITTEE ON FINANCE HEARING

Senator Bob Packwood (R-Oregon), Chairman of the Committee on Finance, announced today the scheduling of a Friday, March 29, 1985, full committee hearing on the findings of the President's Commission on Industrial Competitiveness.

The blue-ribbon commission's report, "Global Competition--The New Reality," was released January 25. President Ronald W. Reagan appointed the commission with the charge to make suggestions for improving international competitiveness by American exporters. The panel included distinguished representatives of American business, industry, labor and education.

Several members of the commission are expected to present testimony before the Committee on Finance.

"I am quite enthusiastic about the report of this commission," Chairman Packwood said. "This hearing before the Committee on Finance will provide the commission as well as members of Congress the opportunity to engage in a dialogue on specific proposals of this fine group of Americans."

The hearing is scheduled to begin at 9:30 a.m., Friday, March 29, 1985, in Room SD-215 of the Dirksen Senate Office Building.

Legislative Reorganization Act: Senator Packwood said the Legislative Reorganization Act of 1946, as amended, requires all witnesses appearing before the Committees of the Congress "to file in advance written statements of their proposed testimony, and to limit their oral presentations to brief summaries of their argument."

Witnesses scheduled to testify should comply with these rules:

(1) All witnesses must submit written statements of their testimony.

(2) Written statements must be typed on letter-sized paper (not legal size) and at least 100 copies must be delivered no later than noon on Thursday, March 28, 1985, to Anne Cantrel, Administrative Director, United States Senate, Committee on Finance, Washington, D.C. 20510.

(3) All witnesses must include with their written statements a one-page summary of the principal points included in the statement.

(4) Oral presentations should be limited to a short discussion or principal points included in the one-page summary. Witnesses must not read their written statements. The entire prepared statement will be included in the record of the hearing.

Written Statements: Others who wish to present their views to the Committee are urged to prepare a written statement for submission and inclusion in the printed record of the hearing. These written statements should be typewritten, not more than 25 double-spaced pages in length and mailed with five copies to Anne Cantrel, Administrative Director, United States Senate, Committee on Finance, Washington, D.C., 20510, not later than Friday, March 29, 1985. On the first page of the written statement, the date and subject of the hearing should be indicated.

P.R. #85-007

United States Senate

COMMITTEE ON FINANCE
WASHINGTON, DC 20510

MARCH 28, 1985

MEMO

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FROM: FINANCE COMMITTEE STAFF (LEN SANTOS x4-5472)

TO: FINANCE COMMITTEE MEMBERS

SUBJECT: MARCH 29, 1985 COMMITTEE HEARING ON THE INDUSTRIAL COMPETITIVENESS REPORT

The Finance Committee will conduct a hearing on Friday, March 29, 1985, on the Report of the President's Commission on Industrial Competitiveness. The hearing will begin at 9:30 a.m. in SD-215. A witness list is attached. All witnesses are members of the Commission. Copies of the two volume Commission report are available from the Finance Committee (Mary Melrose x4-5472) and will be supplied to each member at the hearing.

Following is a summary of the Report.

I. BACKGROUND

President Reagan established the President's Commission on Industrial Competitiveness in June 1983, to consist of 30 leaders from business, labor, government, and academia. The commission was charged with identifying ways to improve the private sector's ability to compete. After submitting its recommendations to the Cabinet Council on Commerce and Trade, the Commission published its report in January 1985.

II. ANALYTICAL CONTEXT

A. Definition

The report is based on the premise that an internationally competitive U.S. economy is a prerequisite for the national goals to which Americans aspire, which are described as

1. a rising standard of living for all Americans,

2. the U.S. position as leader of the free world, and

3. U.S. national security.

Competitiveness for a nation is defined as the degree to which it can, under free and fair market conditions, produce goods and services that meet the test of international markets while simultaneously maintaining and expanding the real income of its citizens.

B. Measures

Competitiveness is measured according to four key indicators:

1. labor productivity,

2. real wage growth,

3. real returns on capital employed in industry, and

4. position in world trade.

C. U.S. Position

On all four counts, the report finds U.S. competitiveness declining in relation to our major trading partners.

1. Labor Productivity

Although the U.S. remains the most productive of the world's major economies, productivity growth in many countries has consistently outstripped that of the U.S. in the last decade.

2. Real Wages

Since 1973, U.S. real wages have stagnated. Real gross domestic product (GDP) per capita, as a broad measure of income that includes other income sources such as interest and transfer payments and reflects such things as work force participation and the age distribution, has grown only one percent per year since 1973. While American wages remain the highest, the U.S. industrial economy is not supporting an increasing standard of living for American workers.

3. Returns on Capital

Since the mid-1960's, real returns on assets invested in manufacturing have declined. Unlike the 1960's, the real rates of return earned by manufacturing assets are substantially below those available on financial assets. As a result, the relative attractiveness of investing in manufacturing has declined.

4. Position in world trade

Although the balance in the merchandise trade account is a reflection of many factors other than competitiveness, such as currency movements, investment flows and debt problems, the steady accumulation of trade deficits since 1971 is evidence of deteriorating competitiveness relative to our trading partners.

Another element of this merchandise deficit is the shifting pattern of U.S. export sales. The U.S. share of world trade in manufactured goods, measured in terms of value, has been declining, and more telling, the U.S. share of high technology exports also declined between 1960 and 1980.

While declining market shares can be discounted merely as a reflection of the natural and inevitable catchup of foreign countries in industries once dominated by the U.S., the gap is being closed in advanced technology industries rather than in just maturing industries. Further, U.S. loss of export shares may suggest loss of capacity to compete in <u>future</u> markets.

These changes have occured in an increasingly interdependent world in which the U.S. occupies a less dominant position. Trade has increased as as share of U.S. GNP from seven percent in 1960 to about 14 percent in 1983. In manufactures trade, exports increased from nine percent of U.S. production in 1960 to about 19 percent in 1980, while imports increased from five to 23 percent during the same period. The shift in the predominant source of U.S. manufactures imports from Europe to Asia is said to reflect, at least in part, new and different development-oriented strategies adopted by these emerging Asian economies. Finally, increasingly rapid changes in technology and its diffusion have permitted newly industrialized countries (NIC's) to enter markets previously dominated by the U.S. Key to this process is the mastery of manufacturing processes, as much as pioneering new products.

D. Summary

Future U.S. competitiveness depends broadly on its investment in technology, people and productive assets, and the environment in which international trade is conducted.

III. DETERMINANTS OF FUTURE COMPETITIVENESS AND COMMISSION RECOMMENDATIONS

The U.S. may be unable to create a comparative advantage with respect to each factor which determines its future competitiveness. The U.S. may choose to retain some disadvantages, such as high labor costs. The object in improving competitiveness is to build on strengths and minimize weaknesses.

Following is the report's assessment of four key factors determining the future of U.S. competitiveness.

A. Technology

1. Assessment

In order for technology to be a continuing and greater competitive advantage, the U.S. must

(a) create a solid foundation of science and technology that is relevant to commercial uses;

(b) apply advances in knowledge to commercial products and processes; and

(c) protect intellectual property by strengthening patent, copyright, trademark and trade secret protection.

Although the U.S. spends a greater share of its GNP on research and development (R&D) than its international competitors, much of the R&D is for defense and space programs in which commercial application is an incidental objective. Furthermore, government needs better management of R&D funds.

In any event, private R&D incentives are needed to fuel advances in commercially useful new technologies. Reversing inadequate support for university research is the starting point. Greater attention to manufacturing technology is essential to translating new product technologies into commercial success. Finally, greater protection must be given intellectual property to enhance incentives for investments in innovation.

2. Recommendations

(a) Create a Cabinet-level Department of Science and Technology to coordinate and integrate fragmented government efforts and highlight the importance of science and technology.

(b) Make the R&D tax credit permanent and make it available for total R&D spending (instead of just incremental spending), for accounting expenses, and for development of equipment and processes involved in prototype development.

(c) Increase and manage better government support for basic research at universities.

(d) Improve manufacturing technology and manufacturing-related university curriculum

(e) Improve international protection for intellectual property rights.

B. Capital

1. Assessment

Because greater investment is generally reflected in productivity increases, improvements must be made in the supply, cost, and freedom of movement of capital. The effect of a relatively low U.S. savings rate is compounded by large federal budget deficits. Higher U.S. capital costs place U.S. industries at a competitive disadvantage, and U.S. tax and regulatory policies contribute to this problem by discouraging saving and taxing interest income. Allocation of capital is also influenced by wide variations of effective tax rates from industry to industry. Ironically, investments in American manufacturing pay the highest effective marginal tax rate.

2. Recommendation

(a) Reduce the federal budget through economic growth and curbing spending.

(b) Restructure the tax code by

(1) increasing savings and investment incentives, taxing consumption, and eliminating double taxation of corporate profits;

(2) reducing variations in effective tax rates on different industries;

(3) indexing for inflation adjustments for capital income and capital expense or loss items;

(4) reducing disincentives to venture and other risk capital investments; and

(5) broadening the tax base by including more income items and reducing the number of tax deductions and exclusions (without discouraging savings and investment).

(c) Pursue stable monetary policy to reduce wide fluctuations in inflation and interest rates.

(d) Reduce government intervention in the free flow of capital.

C. Human Resources

1. Assessment

A national concensus must be reached on improving U.S. competitiveness. Part of this concensus-building involves better cooperation between labor and management. In addition, displaced workers must be helped to develop new skills, while the workforce must be trained to meet the changing employment opportunities. Employers lack incentives to invest in employee training and retraining. Universities are not fully prepared to offer the engineering and business education which will be needed to meet the challenge of foreign competition. In addition to the obvious fundamental importance of the quality of elementary and secondary education systems, these are serious competitive consequences to the school dropout problem and the failure to use technology to enhance educational offerings.

2. Recommendations

(a) Improve the concensus building capabilities of existing Federal advisory committees.

(b) Forge new understandings between management and labor.

(c) Strengthen incentive programs that increase employee motivation.

(d) Improve our ability to redeploy labor affected by changing markets and technologies.

(e) Encourage employers to invest in worker training through tax exemptions for employer-financed tuition. More federal support should be given vocational education.

(f) Increase Federal support for advanced engineering education and research.

(g) Emphasize excellence in elementary and secondary education.

D. Trade

1. Assessment

As the U.S. has grown more dependent on trade, an open and fair trading environment has become more important to U.S. economic growth. The U.S. needs a more coherent trade policy through better coordination of trade policy making. Domestic laws must be more responsive to legitimate industry complaints and must address novel forms of unfair trade practices which distort world markets. U.S. antitrust laws, among others, must be adjusted to reflect modern market realities. U.S. export controls have become an ever increasing obstacle to legitimate transactions, while export promotion receives little support. The GATT system needs to be modernized to cover trade in services and investment, and the proliferation of non-tariff barriers.

2. Recommendations

(a) Create a Department of Trade to intergrate trade policymaking and give it more prominence.

(b) U.S. trade laws should be strengthened to provide adequate remedies for industries affected by foreign competition.

(c) Change U.S. antitrust law to recognize the new global markets,

(d) Give greater weight to competitiveness cosiderations in applying export controls.

(e) Intensify trade promotion efforts.

(f) Prepare for a new round of trade negotiations to address the new areas of concern in trade.

STATEMENT OF SENATOR PACKWOOD

TODAY'S HEARING OFFERS THIS COMMITTEE AN OPPORTUNITY TO DISCUSS WITH THE DISTINGUISHED MEMBERS OF THE PRESIDENT'S COMMISSION AN INDUSTRIAL COMPETITIVENESS THE IMPORTANT ANALYSIS AND RECOMMENDATIONS CONTAINED IN THE COMMISSION'S REPORT.

THE ISSUE OF OUR INDUSTRIAL COMPETITIVENESS IS CENTRAL TO OUR NATIONAL WELL BEING. THIS ISSUE GOES TO THE HEART OF OUR STANDARD OF LIVING AND OUR NATIONAL SECURITY; IN SHORT OUR FUTURE AS A NATION IS INVOLVED.

THE FINANCE COMMITTEE'S ROLE IN SETTING THIS COUNTRY'S TAX AND TRADE POLICIES PLACES ON THE COMMITTEE'S MEMBERS AN IMPORTANT RESPONSIBILITY TO UNDERSTAND THE FORCES THAT DETERMINE OUR INDUSTRIAL COMPETITIVENESS. NONE OF US CAN DO OUR JOBS ON THIS COMMITTEE WITHOUT A VISION OF THE TAX AND TRADE POLICIES THAT BEST SERVE THIS COUNTRY. THESE ARE ISSUES WHICH I HAVE ANALYZED AND DISCUSSED FOR MANY YEARS, AND I WELCOME THIS OPPORTUNITY TO EXCHANGE VIEWS WITH LEADERS FROM THE PRIVATE SECTOR WHO HAVE DONE THE SAME.

WE TEND TO BLAME OUR GROWING TRADE DEFICITS ON THE STRONG DOLLAR, FOREIGN TRADE BARRIERS, THE PROBLEMS OF

THE DEBTOR COUNTRIES AND THE ADVANCED STATE OF OUR ECONOMIC RECOVERY RELATIVE TO OTHER NATIONS. THE COMMISSION'S REPORT MAKES IT CLEAR THAT THERE IS ANOTHER FACTOR AS WELL -- WE ARE SIMPLY NOT KEEPING PACE WITH OUR MAJOR TRADING PARTNERS IN INDUSTRIAL PRODUCTIVITY INCREASES.

WE HAVE AN ABYSMALLY LOW SAVINGS RATE, HIGH CAPITAL COSTS, LAGGING INVESTMENT IN COMMERCIALLY-APPLICABLE RESEARCH AND DEVELOPMENT AND A HOST OF OTHER PROBLEMS WHICH DIMINISH OUR POTENTIAL INDUSTRIAL COMPETITIVENESS. TO PARAPHRASE WINSTON CHURCHILL'S STATED RELUCTANCE TO PRESIDE OVER THE DEMISE OF THE BRITISH EMPIRE, I INTEND TO PRESIDE, AS CHAIRMAN OF THIS COMMITTEE, OVER A CONCERTED EFFORT TO REVERSE OUR DECLINING COMPETITIVENESS.

STATEMENT BY SENATOR MAX BAUCUS
SENATE FINANCE COMMITTEE
HEARING ON REPORT OF THE PRESIDENT'S COMMISSION ON INDUSTRIAL COMPETITIVENESS
MARCH 29, 1985

INTRODUCTION

THANK YOU, MR. CHAIRMAN.

IN 1983 PRESIDENT REAGAN PREDICTED "A FUTURE IN WHICH COMMERCE WILL BE KING, THE EAGLE WILL SOAR, AND AMERICA WILL BE THE MIGHTIEST TRADING NATION ON EARTH."

WELL, COMMERCE MAY BE KING.

AND EAGLES MAY SOARING.

BUT THEY'RE NOT AMERICAN EAGLES.

AMERICA'S TRADE PERFORMANCE HAS NEVER BEEN WORSE.

LAST YEAR, THE TRADE DEFICIT WAS OUR HIGHEST IN HISTORY--$123 BILLION. TO PUT IT ANOTHER WAY, FOR EVERY $1 WORTH OF U.S. PRODUCTS GOING OUT, THERE WERE ABOUT $1.57 WORTH OF FOREIGN PRODUCTS COMING IN.

SO HOW DID WE START THE NEW YEAR?

JANUARY'S TRADE DEFICIT GREW AT A FASTER RATE THAN LAST YEAR'S.

AND YESTERDAY WE LEARNED THAT FEBRUARY'S DEFICIT WAS EVEN WORSE THAN JANUARY'S.

THE FEBRUARY TRADE DEFICIT WAS $11.5 BILLION. THAT'S 12% HIGHER THAN JANUARY'S DEFICIT, AND 10% HIGHER THAN LAST FEBRUARY'S.

THE TRADE CRISIS

THESE HUGE DEFICITS ARE NOT JUST ABSTRACT STATISTICS FOR ECONOMISTS TO DEBATE. THEY HAVE A PROFOUND EFFECT ON EVERY AMERICAN.

--OUR <u>FARMERS</u> ARE THE MOST EFFICIENT IN THE WORLD. BUT THEY'RE BEING DRIVEN OUT OF EXPORT MARKETS.

--OUR <u>MINERS</u> ARE GIVING UP HOPE. IN BUTTE, EVERY MINE IS CLOSED AND 13,000 PEOPLE HAVE LOST THEIR JOBS.

--OUR <u>TIMBERMEN</u> ARE BEING INUNDATED WITH SUBSIDIZED CANADIAN IMPORTS.

--AND WE'RE LOSING CORE MANUFACTURING INDUSTRIES THAT ARE VITAL TO THE LONG TERM VITALITY OF OUR ECONOMY. AS LESTER THUROW--WHO, BY THE WAY, HAILS FROM GREAT FALLS, MONTANA--SAYS, "IF YOUR MANUFACTURING INDUSTRY GOES DOWN THE DRAIN, MOST OF THE SERVICES WILL GO DOWN WITH THEM."

<u>SOLUTIONS</u>

SO WHAT SHOULD WE DO?

FIRST OF ALL, WE MUST REDUCE THE INTERNATIONAL VALUE OF THE DOLLAR, WHICH IS MAKING IMPORTS CHEAP AND EXPORTS EXPENSIVE.

THIS WEEK'S DECLINE HAS BEEN HELPFUL, BUT THE DOLLAR IS STILL AT THE SAME LEVEL IT WAS IN JANUARY.

TO BRING THE DOLLAR DOWN FURTHER, WE MUST REDUCE THE FEDERAL BUDGET DEFICIT. AND, WHEN NECESSARY, WE MUST INTERVENE IN INTERNATIONAL CURRENCY MARKETS.

SECOND OF ALL, WE NEED A TOUGHER TRADE POLICY.

AS PRESIDENT REAGAN HIMSELF RECENTLY SAID, "WE CANNOT PLAY INNOCENTS ABROAD IN A WORLD THAT IS NOT INNOCENT."

THIS IS AS TRUE FOR TRADE POLICY AS FOR ANYTHING ELSE.

OTHER COUNTRIES ARE WAGING A TRADE WAR. BUT, IN RESPONSE, THE ADMINISTRATION SEEMS TO HAVE NO COHERENT TRADE POLICY.

IN FACT, NOW WE DON'T EVEN HAVE A TRADE REPRESENTATIVE, BECAUSE THE PRESIDENT APPARENTLY HAS DECIDED THAT BILL BROCK IS TOO TALENTED FOR USTR.

THIS COMMITTEE HAS BEEN FORCED TO FILL THE VOID, BY TAKING ACTIONS LIKE YESTERDAY'S RESOLUTION CALLING FOR RETALIATION AGAINST JAPAN. FORTUNATELY, WE HAVE TRADE EXPERTS LIKE SENATOR DANFORTH AND SENATOR BENTSEN TO LEAD THIS EFFORT.

BUT CONGRESSIONAL ACTION CAN NEVER TAKE THE PLACE OF A TOUGH, COHERENT ADMINISTRATION POLICY.

THIRD OF ALL, WE MUST REFORM THE GATT.

YOU KNOW, SOMETIMES I THINK WE GAVE IT THE WRONG NAME.

INSTEAD OF CALLING IT THE "GENERAL AGREEMENT ON TRADE AND TARIFFS," WE SHOULD HAVE CALLED IT THE "GENTLEMEN'S AGREEMENT TO TALK."

BECAUSE THAT'S ALL THAT SEEMS TO HAPPEN OVER THERE IN GENEVA: TALK.

MAYBE THAT'S ALL THAT SHOULD HAPPEN. BUT IF THAT'S SO, WE SHOULD STOP TAKING THE WHOLE THING SO SERIOUSLY.

AND IF THAT'S NOT SO--IF THE GATT SHOULD REALLY GUIDE INTERNATIONAL TRADE BEHAVIORE, THEN WE MUST OVERHAUL THE RULES AND PROCEDURES SO THAT THEY MAKE SENSE IN TODAY'S WORLD.

THE YOUNG COMMISSION REPORT

THE YOUNG COMMISSION REPORT EMPHASIZES HOW SERIOUS THE TRADE CRISIS HAS BECOME.

AND THE REPORT'S RECOMMENDATIONS ARE AN IMPORTANT CONTRIBUTION TO OUR DEBATES ABOUT BUDGET POLICY, TAX POLICY, AND TRADE POLICY.

I'D LIKE TO CONTRATULATE MR. YOUNG AND THE OTHER COMMISSION MEMBERS FOR THE SIGNIFICANT CONTRIBUTION THEY HAVE MADE.

CONCLUSION

IN THE SWEEP OF HISTORY, NATIONS RISE AND FALL. THERE'S NO GUARANTEE OF CONTINUED SUCCESS. THAT'S AS TRUE FOR THE UNITED STATES AS FOR ANY OTHER NATION.

IN INTERNATIONAL TRADE, AMERICA FACES A GREAT CHALLANGE.

WE CAN MEET THAT CHALLENGE, FOR WE ARE A GREAT NATION.

BUT IT WILL TAKE SIGNIFICANT POLICY CHANGES OF THE SCOPE RECOMMENDED IN THE YOUNG COMMISSION REPORT.

I LOOK FORWARD TO EXPLORING THOSE RECOMMENDATIONS DURING TODAY'S HEARING.

The CHAIRMAN. I apologize for being a bit late; I have been meeting with the leader in the budget group, attempting to reach the cuts that we hope we can get the votes for to pass.

I have read your report. That is one of the things that you mentioned in your report in terms of our international competitiveness.

I do have an opening statement. I am simply going to ask, for the sake of brevity, that it be placed in the record. I know that our first witness has to leave by 10:15 to go to the White House, so I am going to call on him now to make his statement. I have a few questions, and then we will call the panel afterwards.

My first witness is John Young, the chairman, president, and chief executive officer of Hewlitt Packard, and I believe Senator Wilson is here to introduce him.

STATEMENT OF SENATOR PETE WILSON OF CALIFORNIA

Senator WILSON. Thank you very much, Mr. Chairman. And if your tardiness was occasioned by that effort, we will all forgive you and wish the outcome well.

Mr. Chairman, I am very grateful for the opportunity and the privilege to appear before the committee to introduce John Young, and I commend the chairman and the committee for calling this hearing today to consider the work of the President's Commission on Industrial Competitiveness.

It has been my privilege to know John Young for a number of years, and through those years my respect for him has grown, both as a person and as an outstanding corporate leader in my home State, California.

As the chairman and chief executive officer of Hewlitt-Packard, he has earned the respect of those within his own industry and, more importantly, many more outside it.

The industry for which he speaks as a participant is the electronics industry, but he is here today in a much broader capacity.

Mr. Chairman, when people say that Hewlitt-Packard has been operating at the cutting edge, they are not just referring to the electronic products which it has designed and manufactured. Hewlitt-Packard has been at the very forefront of enlightened management techniques, which has allowed it to become a true force in a very competitive marketplace, both domestically and internationally.

John Young has led that effort. He has been an outstanding contributor to the success that Hewlitt-Packard has attained.

Mr. Chairman, with all of this in mind, I was particularly fortunate, personally, to have secured his assent to heading my Advisory Committee on High Technology, a committee I formed shortly after being elected to the Senate. And the advice that I have received from Mr. Young and from the other leaders of high technology companies has been of invaluable worth to my education and to the work that I am attempting to do on behalf of that industry. It has ranged in issues from the R&D tax credit to their concern about competitiveness, which you are addressing this morning.

I was enormously pleased that President Reagan also took note of John Young's great intellect and his experience and organizational skills in asking him to head the Commission on Industrial Competitiveness.

I think the final report by the Commission clearly indicates that the President's trust was well-placed, and, Mr. Chairman, even if the members of the Finance Committee don't find themselves in total agreement with all of the Commission's recommendations, I am sure that at least they will recognize the great value of the analyses and findings which the Commission presents to them this morning.

Of particular value to the committee, I am sure, is the work of the Commission on the negative impact that our tax system has had on competitiveness. I particularly commend to the committee's attention the recommendation made by the Commission that we move from a system that rewards consumption to a system that rewards savings and encourages them.

It is important to understand that our present system has made us a country with the lowest rate of savings among our industrialized economic partners and, not coincidentally, has placed us among those with the lowest rate of improvement in productivity.

But, Mr. Chairman, you have indicated that there is a time problem on behalf of Mr. Young, and you generously put your own statement in the record.

I am grateful to you for holding the hearing and for allowing me the privilege of introducing Mr. Young.

The CHAIRMAN. Senator Wilson, thank you very much. I am not as intimately familiar with all of Hewlitt-Packard as you are, but I have visited your plant in Corvallis, OR, on a number of occasions, and it is not only an excellent facility, but your entire industrial park and the taste with which you have done it is a model for the country.

Mr. Young, we are glad to have you with us.

STATEMENT BY JOHN A. YOUNG, CHAIRMAN OF COMMISSION, PRESIDENT AND CHIEF EXECUTIVE OFFICER, HEWLETT-PACKARD CO., PALO ALTO, CA

Mr. YOUNG. Thank you.

Senator Packwood, thank you for inviting me to speak today about the work of the President's Commission on Industrial Competitiveness.

I really can't summarize all of the findings of the Commission in just a brief presentation, but I would like to just outline a menu of the topics that have come under the umbrella of competitiveness, and in the time remaining we can discuss those issues that you have more of an interest in.

In the past few months my fellow Commissioners and I have been speaking about our agenda, suggesting that perhaps what we need is another Sputnik; except in this case we are suggesting that perhaps the Japanese ought to launch a Toyota into space. [Laughter.]

We are saying this because the competitive challenge this Nation faces has consequences just as grave as the threat posed by Sputnik a quarter of a century ago. Fortunately, the dimensions of this challenge are more subtle and very hard to dramatize on the evening news.

I think a sense of urgency is needed because improving our ability to compete is key to the attainment of just about any of our other national goals.

The Commission has defined competitiveness as the ability of the American economy to produce goods and services that meet the test of international markets while at the same time maintaining our standard of living.

An increased standard of living, more and better jobs, our national security, these all depend on our ability to compete in world markets. So, too, does our ability to address the budget and trade deficits.

In regard to this latter challenge, let me add that increased protectionism here at home doesn't solve the competitive problem; it merely postpones our dealing with it and invites our trading partners to close off important opportunities for American exporters.

I don't think it necessary to tell this committee how dramatically the world economy has changed over the past 2 decades or how much our own economy depends on international trade. Let me instead highlight the importance of a new set of competitors—Japan and the newly industrializing nations of the Pacific Rim.

We now do more trade with these nations than with all of Europe combined. We must not congratulate ourselves because our economy is outperforming Europe; that's like congratulating ourselves on finishing second to last in a race.

We also shouldn't be too comforted by the strength of our recent economic expansion. That's like a runner taking pride in doing his fastest race ever, but still not finishing in the top ranks of the competition.

It is our conclusion that this Nation's ability to compete has declined over the past 2 decades. There are some signs of competitive renewal in the last few years, but we haven't made up for the years of decline.

Now, we've been looking at long-term economic trends, not short-term cycles. The five indicator trends that give us cause for concern are presented quite graphically in our final report, but let me just quickly list them here. No single indicator adequately measures competitiveness, but in combination they present an adequate and disturbing picture of our performance.

First is the increasing trade deficit. Now, the strong dollar has greatly magnified this problem, but our trade deficits started for the first time in the early 1970's. In this entire century, until 1970, we had a positive trade balance every year. During the 1970's when the dollar was widely thought to be undervalued, we started having our negative trade situation.

Second, 7 out of 10 American high technology sectors have lost world market shares since 1965. In 1984 our bilateral trade deficit with Japan in electronics was about $15 billion, greater than our bilateral deficit for passenger cars

The loss of American leadership in technology markets would have grave consequences for our entire economy. Technology has been our strongest advantage in world trade.

It is the driving force behind the productivity gains that make our high wages possible. It is the creative force behind the formation of whole new kinds of industries and jobs.

Third, our vital manufacturing sector has experienced declining rates of return on assets—rates that are uncompetitive with alternative financial investments. A strong manufacturing base is vital to our Nation's well being. I don't think we can rationalize the poor performance of our manufacturing industries by pointing to the future service economy.

Fourth, our productivity growth rate over the last 2 decades is outstripped by just about all of our major trading partners. Japan's rate of growth has been five times our own country. Their absolute productivity in autos, steel, and precision machinery, and others, exceeds our own, and it is no coincidence that these are the industries most pressured by foreign competition.

Fifth, the real hourly wages received in our business sector have been virtually stagnant for the past 10 years. You will recall that our definition of competitiveness is defined as our ability to succeed in world markets while maintaining our standard of living. We simply haven't met that test.

Let's look at some of the factors, then, that contribute to this performance.

Technology is our greatest advantage, yet this country spends relatively less than its competitors on civilian R&D; that is, the kinds of inquiry that can lead to commercial advantage. That is why we proposed better coordination and effectiveness of all Federal nondefense R&D efforts. They represent an $18 billion annual investment from which we think we could get a much greater competitive advantage.

We have also called for more emphasis—in industry, in our Nation's universities, and in our Federal laboratories—on manufacturing technology. It does us little good to produce state-of-the-art equipment if within a short time another country can replicate and manufacture the same thing at half the cost. And very often that is exactly what is being done in Japan and the newly industrializing nations of the Pacific Rim.

The CHAIRMAN. Say that again, will you?

Mr. YOUNG. I am saying that we have world class science, but it does little good to have that quality of science if we cannot translate that into production goods and be the low-cost producer. Very typically, Japan and the newly industrialized countries can make products of similar quality at perhaps half the cost.

The CHAIRMAN. Let me ask you a question. I won't interrupt you very often, but I'm curious. Even with world class science, and assuming we had the engineering capacity to reasonably quickly turn that into productive capacity, how would that give us a much greater advantage over Japan or elsewhere? I mean, they can turn it just as fast as we can, can't they?

Mr. YOUNG. That is my point. Well, they can turn it more quickly than we can. My point is, we have not concentrated on manufacturing technologies; it has been a neglected area of investment in universities, companies, and as supported by the Federal Government research programs. That is an area in which we think great stimulation could go on to great effect. We need to have even greater productivity because our wages are relatively higher. So that is the reason for my point: our inattention to the area of manufacturing technology has been really costly.

To move on to the question of capital, which is highly related to this kind of investment, we heard testimony from a wide range of economists who actually agreed with each other. The cost of capital in the U.S. industry is significantly higher than for their competitors abroad. Compared to Japan, U.S. costs are twice as high. Here, reducing the deficit and pursuing a stable monetary policy and other actions in the tax arena are of great assistance.

We have also proposed some criteria by which we can judge the competitive effects of various proposals for tax reform. Our own study has led us to conclude that the wide discrepancy between the effective tax rates for different industries has serious economic and competitive consequences.

It is worth noting that the sector most affected by international competition—that is, manufacturing—has the highest effective tax rate. Our goal should be a Tax Code that is more neutral in its treatment of savings versus borrowing and in the tax consequences of different kinds of asset investments.

In the area of human resources we have a great deal to do in learning to work together more cooperatively, in forging a common purpose within our business organizations, and in providing training and retraining opportunities, in addition to strengthening the ability of our universities to train engineers and business leaders. The Commission offers recommendations in all of these areas.

In the international trade environment, the Commission's first conclusion is that this Nation needs to make trade a national priority. Our final report contains a chart that tries to summarize who makes and who implements trade policy. The layout looks more complicated than the schematic for our advanced integrated circuits that we make in our plant in Corvallis. That is why we call for the creation of a Department of Trade. This is not politically feasible this year, but I hope we can pursue other methods of creating a strong, single voice for trade here in the United States, because without this kind of a strong advocacy, we will be unable to deal with the growing importance and complexities of the international trade arena.

If trade really were a national priority, the Commission would pursue changes in U.S. trade laws, antitrust, export controls, and trade promotion efforts. We made recommendations in all of these areas.

To shift to the international trading environment, in which American business operates, we were struck by the fact that while the total volume of world trade is growing dramatically, the proportion of that trade covered by the rules of international agreement has diminished. That is why the Commission called for a new round of GATT negotiations to achieve some coverage for trade in services and agriculture, foreign government targeting and tax policies.

Let me make a personal observation. As you look at many of our recommendations, you will note that there is not a lot that is brand new. We haven't suggested one single action that is going to improve our Nation's ability to compete. That is because there simply is no substitute for attention to the basics.

We haven't identified any new roles for Government. Instead, we have tried to make it clear that Government hasn't yet effectively performed the legitimate roles with which it is charged. Public policy provides the environment within which American industry competes, but we have not yet succeeded in creating that environment to fully assist American competitiveness.

Thank you for the opportunity to comment. I will be happy to discuss with you these points or other parts of our report.

[Mr. Young's prepared statement follows:]

Statement of John A. Young, Chairman
President's Commission on Industrial Competitiveness
to the Finance Committee of the U.S. Senate
March 29, 1985

Senator Packwood, honorable members -- thank you for inviting me to speak to you today about the work of the President's Commission on Industrial Competitiveness. This morning I'm not going to try to condense all the findings and recommendations of the Commission into a ten-minute presentation. Instead, I'd like to present a menu of topics that come under the umbrella of competitiveness and invite you to explore these with me and my fellow commissioners during the question session.

In the past few months my fellow Commissioners and I have been going around the country suggesting that what we need is another Sputnik -- or perhaps a Toyota or Sony Walkman launched into space. Because the competitive challenge this nation faces has consequences just as grave as the threat posed by Sputnik a quarter of a century ago. Only this challenge is a little more subtle -- and less easily pictorialized on the evening news.

I think that sense of urgency is needed because improving our ability to compete is key to the attainment of just about any other national goal to which we may aspire. The Commission defined competitiveness as the ability of the American economy to produce goods and services that meet the test of international markets <u>while at the same time maintaining our standard of living</u>.

An increased standard of living, more and better jobs, our national security -- <u>all</u> depend on our ability to compete in world markets. So, too, does our ability to address the budget and trade deficits.

And in regard to that latter challenge, let me add that increased protectionism here at home doesn't solve the competitive problem. It merely postpones our dealing with it and invites our trading partners to close off important opportunities for American exporters.

I don't think it necessary to tell this Committee how dramatically the world economy has changed over the past two decades or how much our own economy depends on international trade. Let me instead highlight the importance of a new set of competitors -- Japan and the newly industrializing nations of the Pacific Rim.

We now do more trade with these nations than with all of Europe combined. We must <u>not</u> congratulate ourselves because our economy is outperforming Europe. That's like congratulating ourselves for finishing a race second to last.

We also shouldn't be too comforted by the strength of our recent economic expansion. To continue my race analogy, that's like a runner taking pride in doing his fastest race ever. That performance doesn't win any prize if someone else runs an even faster race. A runner's competitiveness can't be judged in isolation, and neither can a country's.

It is the Commission's conclusion that this nation's ability to compete has declined over the past two decades. There are some signs of competitive renewal over the past few years under the leadership of the Administration. But we haven't made up for years of decline.

We've been looking at long-term economic trends, not short-term cycles. The five indicator trends that give us cause for concern are presented quite graphically in our final report, but let me just quickly list them here. No single indicator adequately measures competitiveness, but in combination these present an adequate and disturbing picture of our performance.

First, increasing trade deficits. The strong dollar has greatly magnified this problem, but our trade deficits started for the first time in the early 1970s, when the dollar was widely thought to be undervalued. I think we should expect that the strong dollar is likely to be around for a while, since the U.S. remains an attractive investment environment.

Second, seven out of ten American high-technology sectors have lost world market share since 1965. In 1984, our bilateral trade deficit with Japan in electronics was about $15 billion dollars -- greater than our bilateral deficit for passenger cars.

Loss of American leadership in technology markets would have grave consequences for our entire economy. Technology has been our strongest advantage in world trade.

It's the driving force behind the productivity gains that make our high wages possible. It's the creative force behind the formation of whole new kinds of industries and jobs.

Third, our vital manufacturing sector has experienced declining rates of return on assets -- rates that are uncompetitive with alternative financial investments. A strong manufacturing base is vital to our nation's well-being. I don't think we can rationalize the poor performance of our manufacturing industries by pointing to the future service economy.

Fourth, our productivity growth rate over the past two decades is outstripped by just about all our major trading partners. Japan's rate of growth has been five times our own, and their productivity exceeds ours in autos, steel, and precision machinery. It's no coincidence that these are the industries most pressured by foreign competition.

Fifth, the real hourly wages received in our business sector have been virtually stagnant for the past ten years. You'll recall that we defined competitiveness as our ability to succeed in world markets <u>while maintaining our standard of living.</u> This final indicator suggests we are not meeting that test.

All right. Let's take a look at some of the factors that influence our ability to compete and what needs to be done to improve our performance.

Technology is our greatest advantage. Yet this country spends relatively less than its competitors on civilian R&D -- that is, the kinds of inquiry that can lead to commercial advantage. That is why we have proposed better coordination and effectiveness of all federal non-defense R&D efforts. They represent an $18 billion annual investment from which we could reap greater competitive advantage.

We have also called for more emphasis -- in industry, in our nation's universities, and in our federal laboratories -- on manufacturing technology. It does us little good to produce state-of-the-art equipment if, within a short time, another country can replicate and manufacture the same thing at half the cost. Very often, that is exactly what is being done in Japan and the newly industrializing nations of the Pacific Rim.

To move on to the question of capital, we heard testimony from a wide spectrum of economists who actually agreed that the cost of capital to U.S. industry is significantly higher than for their competitors abroad. Compared to Japan, U.S. costs are twice as high. Here reducing the federal deficit and pursuing more stable monetary policy can be of great assistance.

We have also proposed some criteria by which we can judge the competitive effects of various proposals for tax reform. Our own study has led us to conclude that the wide discrepancy between the effective tax rates for different industries has serious competitive consequences.

It's worth noting that the sector most affected by international competition -- that is, manufacturing -- has the highest effective tax rate. Our goal should be a tax code that is more neutral in its treatment of savings versus borrowing and in the tax consequences of different kinds of asset investments.

In the area of human resources, we have a great deal to do in learning to work together more cooperatively, in forging a common purpose within our business organizations, and in providing training and retraining opportunities, and in strengthening the ability of our universities to train engineers and business leaders. The Commission offers recommendations in all these areas.

In the international trade environment, the Commission's first conclusion is that this nation needs to make trade a national priority. Our final report contains a chart that tries to summarize who makes and implements trade policy. The layout looks more complicated than a design schematic for the most advanced integrated circuit my company manufactures.

That is why we called for the creation of a Department of Trade, and if this is not politically feasible this year, I hope we will pursue other methods of creating a strong, single voice for trade here in the U.S. Without that strong advocate, we will be unable to deal with the growing importance and complexities of the international trade arena.

f trade really were a national priority, we would pursue changes in U.S. domestic trade laws, antitrust, export controls, and trade promotion efforts. The Commission made recommendations in all these areas.

To shift to the international trading environment in which American business operates, we were struck by the fact that while the total volume of world trade is growing dramatically, the proportion of that trade covered by rule of international agreement has diminished.

That is why the Commission called for a new round of GATT negotiations to achieve some coverage for trade in services and agriculture, foreign government "targeting" tax policies, countertrade, protection of intellectual property, and non-tariff barriers.

Let me make a personal observation. As you look at many of our recommendations, you'll note that there's not a lot there that is brand new. We haven't suggested one, simple action that's going to improve this nation's ability to compete. That's because there is no substitute for attention to the basics.

We haven't identified any new roles for government. Instead, what we've tried to make clear is the fact that government hasn't yet effectively performed the legitimate roles it already has. Public policy provides the environment within which American industry competes. We have not yet succeeded in creating an environment conducive to American competitiveness.

What do I think will be the result of the Commission's efforts? It's still too early to judge; history moves a bit more slowly than that. Of this I am sure: We have already accomplished one of our prime goals. Lawmakers and administrators in this fine city are beginning to ask the question they must pose in their daily decisions: "How does this action affect our ability to compete?"

I want you to know that for a different audience -- say, to a group of business leaders -- I'd have presented a different set of action items. I would have stressed that the responsibility for being competitive rests with the private sector -- that government can't legislate success.

I would have talked about the importance of thinking internationally, being responsive to customers, paying attention to cost and quality, and forging a unified team of people within their organizations. Since these are challenges you cannot help us face, I've chosen not to address them this morning.

But I want you to understand that we in the business community <u>have</u> taken on the challenge of global competition -- that we haven't been waiting for this Commission to report or for Congress to act. We accept our responsibility. We ask for your support in the competitive challenge we face -- and your action in the areas where government can make a contribution.

Thank you for your attention. I'm open to questions.

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The CHAIRMAN. Max, Mr. Young has to leave about 10:15, although I think between the two of us we may not use up 25 minutes in questions.

Let me ask you a couple: The savings rate is often mentioned. We will compare ourselves to Japan, which has almost three times our savings rate, to most of the European industrial countries which have about twice our savings rate, and yet historically our savings rate has never been over 8 to 8.2 percent, and during the fifties and sixties was around 7.5, 7.9. Why did we do so well in those days with a savings rate that was still comparatively low in relation to other countries?

Mr. YOUNG. Well, I don't know the answer to that question. I would have to just give you my personal view. I think that is the relative price of American labor in world markets. It was probably relatively less than today's.

The CHAIRMAN. It was probably what?

Mr. YOUNG. It was probably less than it is today; that is capital and technology is so much more important today, considering the cost base of so many of today's competitors.

One of the things I think has changed over the last 20 years is the mobility of technology. It is really striking to me as I visit countries like South Korea to find that companies like Samsung Electronics are manufacturing state-of-the-art electronic products highly efficient, with the best kinds of statistical quality control techniques modeled exactly after the Japanese, with the same kinds of automated investments that are typical of our plants and the Japanese, and yet direct labor rates were 40 cents an hour.

Now, this puts the real dimension on the kind of productivity improvement we have to make and the role of capital in doing it.

The CHAIRMAN. How on Earth, if their labor rates are 40 cents an hour and ours for equivalent industries—let's assume textiles—might be $7 or $8 an hour, and if it's hard goods it's probably higher? If we had a savings rate of 14 percent and they had one of 14 percent, and if our access to capital was as good as theirs, and if they could turn scientific advancement into machines as quickly as we could, assuming all of that, how on Earth can we compete if their wage rate is that low? If everything else is equal, and if their rate is one-tenth of what we are paying?

Mr. YOUNG. Well, I think if everything else was equal, we couldn't. But I don't think everything else is equal. The United States really has an outstanding infrastructure; we have an accumulation of technological wisdom and know-how that is simply not matched by newly industrializing countries. Yes; they can acquire select technologies, but I think the United States' ability to continue to advance scientific knowledge and to use that knowledge is really not matched by countries like South Korea.

So I think we have to use our strengths, we have to get all of these ingredients going together, to use this technology and to have capital available to make productivity investments.

Now, Fred Dent, one of the later witnesses on the panel and a member of our Commission, is a manufacturer of textiles, and he will probably speak to those comparative ratios. But these businesses are largely capital intensive. One person can tend 25 knitting machines. Whether that person makes $10 an hour or $2 is way less important than whether the cost of capital is 15 cents versus 7.5 cents. These are really significant issues.

The CHAIRMAN. Let me read to you an exchange I had last week when we were having hearings on the Israeli-United States Free Trade Agreement. This was an exchange between Robert Eisen, who was appearing on behalf of the American Fiber-Textile Apparel Coalition and me. I had asked him about this competitiveness, and he said:

"The American textile industry, in my opinion, in almost all areas can successfully compete worldwide, and I think our efficiency is such that we can overcome wage differentials. I recognize that is a big statement, but I firmly believe it. However, when you get over into the area of apparel, there is much more labor-intensive products, and we have only a few limited areas in the United States where I think the technology has been developed where you can produce garments in the United States at a cost level that is below the landed cost from the Orient."

And I said, "You are saying in the textile industry you can compete even with the tremendous wage differential?"

"Yes, sir."

"Whereas, with apparel, that is another matter? And you think, you are not sure?"

"If the illegal subsidies were eliminated, I think we could stand on our feet in the textile industry."

"But not apparel?"

"No."

Are there some industries in this country that, no matter how level the playing field and how fair the competition, simply cannot compete, and that we are going to have to make a decision in this country as to whether or not we are going to guarantee the survival of some industries that otherwise cannot compete? Or maybe not guarantee them, as the case may be, but make that decision?

Mr. YOUNG. That would be where my sentiment is. Surely, some sectors of our economy will not be competitive in world markets. I think our report was careful to articulate the fact that we are certainly not advocating some monolithic competence across the board.

I think the clear specialization of countries is a natural outcome and the market will make those choices very well; but I think it is too simple and too soon in many cases to simply write off any of these industries.

Again, another witness you will have later, if you want to follow this line of questioning, is Howard Samuel. Howard has been for many years interested with the Ladies Garment Workers Union and understands the apparel industry quite well. But there are efforts right now at Draper Laboratories to make a sewing robot. I understand that one of the benchmarks of competence is the ability to sew a sleeve in a suit, and it hasn't passed that test.

This was one of the interesting areas that we looked at, talking about this $18 billion in Federal laboratories, that we might get more use out of with joint efforts with industry. And that was one of the areas we looked at, in establishing a partnership with Federal laboratories in that particular effort, to see if that effort couldn't be accelerated and strengthened by using the mass resources of the Federal laboratories.

The CHAIRMAN. So, you are convinced that if we were to adopt the bulk of the recommendations of the Commission, that almost all American industries—I don't care if they are textiles or shipbuilding or steel or autos or whatever—can compete even against a country that decides that they are going to zero in on steel? They are not going to be competitive in textiles or shoes, they are going to be steel. Or another one, like Korea, says shipyards. That even though they are not trying to be competitive in a broad panoply of areas but only one or two, that we can be competitive in all of them, even against targeted efforts by other countries, if we adopt the recommendations of the Commission?

Mr. YOUNG. That is not what I meant to say if that's what I said. I do believe that there is a theory of advantage, and not all sectors will be pursued by American managers, nor will perhaps technology be equally as applicable at improving things. Maybe ships, possibly we simply don't have any good ideas. Maybe apparel—possibly we do have some good ideas. But I think the market should be sorting out that, not the government. And that is simply what the Commission said.

If we can get the ingredients right—that is, the base of technology and the availability of capital—get some of the ingredients in a more favorable balance, it is our opinion that the market will make those decisions.

The CHAIRMAN. But you mean the international market.

Mr. YOUNG. I mean the international market, for which you don't have to leave home—I want to remind you—to participate in.

Seventy percent of the goods we produce in this country are fully exposed to international competition without ever leaving home.

The CHAIRMAN. Well, I understand that. But I want to be sure of what you are saying, because when we had this hearing on the Israeli Free Trade Agreement, every industry wants to be protected. We are all used to this, and we are big boys, and I understand they are going to come in and, whether it is national security, the textile and apparel industry was saying we cannot fight a war with unclad soldiers. I understand that.

But the next group that wanted protection was the avocado industry. And for the life of me, I tried to think in terms of national security. [Laughter.]

All I could come to was, you know, maybe mock hand grenades. [Laughter.]

I want to know if we are really going to have to make some tough philosophical decisions in this committee that there are some industries in this country that will not be able to compete and that we are not going to protect them and that they are going to disappear.

Mr. YOUNG. I don't think this committee needs to make any decisions except to make sure that the ingredients that American businesses need are fully in place—low-cost capital, wide availability of technology, making sure that the universities' basic research is fully supported. The market will make those tests, because not all sectors have equal competence of management, equal commitment. But I don't think your committee probably needs to make the decisions.

The CHAIRMAN. But I am afraid we will, in this sense: Given that there will be some industries that will disappear from this country—they will go elsewhere—and you are saying, if that is the marketplace, so be it.

Mr. YOUNG. That's what we think.

The CHAIRMAN. That's what?

Mr. YOUNG. That is what our Commission said. We were not recommending active intervention of government to pick and choose and decide which industries ought to be here.

The CHAIRMAN. Now, let me ask you a specific question about taxes and investment. Do you think that the rather extensive surge of investment we have seen in the last 3 years is in any way tied to the passage of accelerated cost recovery in the investment tax credit in 1981?

The reason I ask that is because there is a body of argument that says that would have happened anyway, or it would not have happened unless there was a market and those particular incentives were irrelevant.

Mr. YOUNG. That is not a subject we studied in any great degree. Sam Hartage—again, a later witness—spent all of his time on the Commission looking at capital matters. He may wish to comment further. However, it is probably pretty clear that the accelerated depreciation simply did flow more cash in the corporate sector over the last few years. But who knows? Investment has gone up in a lot of other areas as well.

The CHAIRMAN. One last question, then, which Senator Baucus asked: One of your recommendations is to attempt to achieve relative evenness of taxation between different segments of industry. And yet, the very fact that we passed something like accelerated cost recovery in the investment tax credit makes the tax rates despair it because the nature of some industries use them more than other industries. How do you reconcile that?

Mr. YOUNG. Well, we think that is a problem to be reconciled, and we are quite concerned about the effective tax rates being as they are. Manufacturing sectors are not all extremely capital-intensive.

The CHAIRMAN. That is correct.

Mr. YOUNG. And certainly electronics, that is under a lot of pressure, is not relatively capital-extensive, and it does pay an extremely high tax rate. I think that's the problem.

Now, one of the rationales for passing the R&D tax credit was a way of normalizing that industries that are R&D intensive but are less capital-intensive would have some further offset in their tax base like the nature of the R&D tax credit. That was one set of arguments, along with stimulating more research and development in general.

So I think this is the argument to be reconciled, and I think it is a serious problem, to have a dramatic difference in effective tax rates.

The CHAIRMAN. Max?

Senator BAUCUS. Thank you, Mr. Chairman.

Mr. Young, I think you have made a very important contribution to this debate. Obviously people in the country feel that something's not working the way it should, and I think your committee report is going to help us find a solution.

The question in the back of my mind, as I listened to you and to the questions asked by the chairman, really goes to the degree to which you think American industry and the American Government has to adjust to the trade philosophies of other countries.

What I am getting at is this: The general feeling in America is that the provisions of GATT are rules that countries abide by. But in Europe and Japan GATT is not perceived in the same way; GATT is perceived as not a series of rules but of vague principles that countries can abide by or not abide by depending upon their interests.

In addition to that, to carry it further, Japan and other countries tend to use trade as a very direct arm of their economic development; it is a tool they use to enhance their growth in their own countries. And we in America pride ourselves on free competition, letting each entrepreneur do what he or she can to grow and to turn a profit.

Further, as you know, GATT covers less and less trade as years go by. As countries have grown in the last several years and have developed to become producing countries, they have not always subscribed to GATT. In addition to that, GATT does not cover lots of items of commerce; it doesn't cover very much trade in agriculture, services and capital. The fact of the matter is, it covers about 10 percent of trade in a broad sense today, and it covered much more many years ago.

The fact is, GATT is sort of meaningless in many respects. Sometimes I think GATT should be called "a gentlemen's agreement to talk and talk," because it really doesn't do very much.

So we must consider whether and how to overhaul GATT. Let me ask you, in this regard, what you think the President should recommend, regarding GATT, at the Bonn economic summit?

Do we have to move as Americans a little more toward some kind of an expanded GATT agreement? At the same time, do we have to change our ways a little bit so that we are making some decisions—that is, there are going to be some winners and some losers—in a societal sense? That doesn't necessarily mean a Department of Trade or Commerce, but at least some mechanism that influences who the winners and losers are going to be, rather than letting everybody do the best they can.

Mr. YOUNG. Well, our Commission had several things to say on the subject of trade.

First, I guess in reflecting on this subject we discovered that I think the American public simply takes being competitive for granted. We don't even think about the fact that our national goals, the achieving of them, depends on being competitive. Consequently, we haven't given trade the important role in Government decisionmaking that we give Defense or State Department issues or that kind of thing.

That was one of the first recommendations we made, that we have to recognize that being competitive is as important and in fact integral to any of those other things, and we have to give it a higher national priority. We felt one way of doing that was to reorganize our trade function and to have a Department of Trade. That is probably not the only one.

I think it needs to have a single strong voice representing it, and it needs to have a kind of priority in its deliberation that other issues get.

Senator BAUCUS. Well, does that necessarily mean that some industries are going to have to end up being if not losers at least lower priorities?

Mr. YOUNG. Absolutely.

Senator BAUCUS. And that means some adjustment process.

Mr. YOUNG. Yes, some adjustment process. There is no thought in our Commission report that we are somehow going to assure that every sector of the economy that might exist today will remain or flourish. I don't think that is the role Government can or should play. The market should make those tests for the most part, but it has to be done within this environment of more or less free and fair trade, which I think is a factor we believe in but it just doesn't exist.

I think we do not use access to the American market, the richest market in the world, as an appropriate tool to ensure that we have reciprocal rights.

The recent telecommunications issue is just a perfect example of that, throwing open our own market when there was no other telecommunications market in the world with which we enjoy reciprocal rights. So that is just a simple target.

Senator BAUCUS. Do you think we can be "tougher" with our trading partners in a way that will not then throw us into a Smoot and Hawley era? That is, can we be tougher in order to accomplish freer trade and encourage other countries to knock down their barriers, or do you think being "tougher" will result in more protectionism worldwide?

Mr. YOUNG. It is a difficult matter to speculate on, but I think, given where we are today, that we can afford to definitely be tougher in our trade negotiations.

Senator BAUCUS. I very much agree with you.

Another question. Often high-tech growth industries are at odds with "rust belt industries" in tax policy and trade policy. The high-tech growth want access to foreign markets; the rust-belt industries want protection because other countries are inundating them unfairly—subsidized or whatever.

So often within the American industry there is a split. Have you been able to gulf that split, bridge that difference, in industries that you are dealing with in your Commission study?

I ask that because I strongly believe there is a strong commonality between both; that is, they needn't be opposed to each other, working in opposite directions, because they are really opposite sides of the same coin, that is, growth of American industry.

Mr. YOUNG. I agree with that.

Senator BAUCUS. Do you find you are able to bridge that, or is that a real problem that we have to somehow work out?

Mr. YOUNG. Well, in the remarks that I perhaps made before you came in, I observed that the electronic trade deficit with Japan—electronics—is bigger than passenger cars in 1984. So, Detroit is not that far from silicone valley.

Again, I believe that the application of technology is so important, not only important to those industries like electronics that inwardly depend on it but it is probably the best way in which those basic industries can improve their own competitiveness. So I agree with you, there are a lot of very common policies, we felt, that if pursued correctly would be very advantageous to that whole sweep of American industry.

We don't see high-tech versus smokestack as some kind of polar opposites.

Senator BAUCUS. Have you thought about what the President should recommend be covered in the next GATT round?

Mr. YOUNG. Well, I think the emerging service business is one to be considered, to maybe head off some potential problems in the future. But I personally think the issue of investment and those kinds of arrangements are extremely important.

I have looked at a lot of commercial transactions to see how many times you are forced to have joint ventures, to give up important rights to obtain market access goes to the trade issue to put a set of ownership criteria in place that subverts the whole idea of free trade access.

I think there are a lot of those kinds of things. In fact, the Emergency Committee on American Trade—ECAT, as it is called—is working with the Export Council to develop an inventory of the trade distortions or the market distorting practices around the world. I have several people in our company actively working on this project since I have been chairing this committee I have become way more sensitive than I was before in my travels to just the enormous number of market distorting activities that go on that we really do not have effective remedies for.

I think if we got an inventory of that, we all would be surprised at just how deep and how extensive those are, how they go way beyond the simple GATT rules of trade.

The CHAIRMAN. How do we make other countries remedy that?

Mr. YOUNG. Well, as I say, I think access to the U.S. market, reciprocal trade rights, are extremely valuable. This is the richest market in the world, and we simply do not ask as much perhaps as we could in terms of reciprocal rights for participating in the U.S. market.

Senator BAUCUS. I think that last point is an excellent one. It is related to another point that I find astounding. The United States imports about 58 percent of Third World countries' total exports. But Japan, a country whose economy is half the size of the United States, only takes about 8 percent of total Third World countries' exports.

So, Japanese barriers to processed forest products, pharmaceuticals, telecommunications and so forth also apply—not necessarily to these products but other products—to Third World countries as well, and therefore those countries' products are diverted to our markets.

Mr. YOUNG. Yes. If you look at the Korean attempt to sell steel to the Japanese, you see just how sophisticated protectionism can become.

Senator BAUCUS. It is tough. I was in Japan 2 months ago at a major electronics plant that produces VCRs. You could tell they are very much looking back over their shoulders at Korea. This company only had one shift, one 8-hour shift per day, and they were just waiting for Korea to build up its VCR industries so they would have to go into a double shift to keep Korean VCRs off the market.

Thank you.

The CHAIRMAN. I was glad to hear your answer, because I think that is what is finally going to come from Congress in terms of retaliation on access to our markets.

Max and I absolutely know that beef from Montana and Oregon can be shipped and sold in the Japanese market at a lower cost than they produce beef, and the same with lumber, and we cannot get in. We just cannot get in.

Mr. YOUNG. Right.

The CHAIRMAN. And I think, much as we both hate to say it, I am prepared to say if that is the game, then they are not going to get into our market with all of their cameras or all of their VCRs, if that is the only language they understand.

Senator BAUCUS. I agree with that.

Mr. YOUNG. Well, I think that is an interesting observation and one I think I agree with, but also it's worth keeping in mind that if you annualize this month's trade deficit with Japan, it is running something close to a $50 billion annual rate. And the best estimates are that if you've had access to all the oranges and all the Oregon beef, that might cut it by a whole $10 billion. So you still have the other $40 billion.

The CHAIRMAN. That's why they are cutting off their nose to spite their face, because the reaction is going to deny them tens of billions of dollars of markets. And if they were to open them to us, it might be $8 or $10 billion if we were able to do everything perfectly where we could compete in their market.

Mr. YOUNG. Well, I think it is in the Japanese strong self-interest to not have this giant deficit. It is destabilizing, and anything you can do to encourage them to face what is good for their long-term interest would be appreciated.

Senator BAUCUS. Mr. Chairman, if I can, I would like to reemphasize that last point, because that is very true. It is absolutely clear that no country in this century has benefited more from an open free-trading system than has the country of Japan. No country has grown more because of an open free-trading system.

As a consequence, no country has more to lose if that system breaks down than does Japan. It is very much in Japan's self-interest to open up its markets, to live up to its new world responsibilities in many areas, in order to keep the free trading system alive. It is very much in Japan's self-interest. More in Japan's, I might add, than any other single country.

Mr. YOUNG. I agree.

The CHAIRMAN. I know you have to run, but Senator Long wanted me to ask this question:

Chairman Volcker says he believes that employee stock ownership is a way to make us more trade-competitive, enabling workers to share in prosperity without building in a floor on costs, and to share in adversity without layoffs.

He also wonders why managers aren't including workers more in their planning options and on the boards of directors.

Do you feel that employee stock ownership is an idea that the Federal Government should encourage in order to make us more trade-competitive?

Mr. YOUNG. The answer to that is yes. Our report is quite clear in its recommendation that getting everyone's personal vectors all lined up in the same way—the company's objectives, the workers' objectives, managers' objectives—is an extremely powerful idea. We think any kind of techniques—stock ownership, a purchase plan, a whole variety of things—that help to align that purpose is a powerful ingredient in increasing the effectiveness of American business in competing.

The CHAIRMAN. Mr. Young, thank you very much. I am sorry we kept you a few moments past 10:15.

Mr. YOUNG. Thank you.

The CHAIRMAN. Now we have the rest of the panel: Mr. Sam Hardage, the chairman of the board of Hardage Enterprises in Wichita; Mr. Fred Dent, president and treasurer of Mayfair Mills in South Carolina; Mr. Bruno Mauer, the president of Rickert Industrial Supply in Milwaukee; and Howard Samuel, the president of the Industrial Union Department of the AFL–CIO.

Gentlemen, I know you have worked out your testimony ahead of time. Do you want to go in the order you are on the list, or do you have a different preference?

Mr. HARDAGE. I will go first, Mr. Chairman.

The CHAIRMAN. All right, let's go with Mr. Hardage first then.

STATEMENT OF SAMUEL A. HARDAGE, COMMISSION MEMBER, CHAIRMAN OF THE BOARD, HARDAGE ENTERPRISES, WICHITA, KS

Mr. HARDAGE. Thank you very much, Mr. Chairman.

My name is Sam Hardage. I am chairman of Hardage Enterprises, an investment and development company based in Wichita, and I served as a member of the PCIC in its Capital Resources Committee.

We all appreciate this opportunity to testify. Because we are well-represented today, I am going to confine my remarks to the capital area and three capital-related issues: the cost of capital, the effect of excess Government spending on capital supply and costs, and the importance of cutting double taxation of corporate income and capital gains taxes.

I think this is very important. The cost of capital generally receives less attention from the press or from the public than does the cost of labor.

The two most important ingredients in our competitiveness posture are labor and capital. We cannot, and I don't think anyone wants to, drive down our cost of labor or wage rates; but we can and should pay attention to the other ingredient which is our cost of capital.

Our cost of capital is important because our companies cannot compete if they don't have an adequate and a low cost of capital.

Several studies that we reviewed during our Commission, one by George Hatsopoulos called "The High Cost of Capital: Handicap of American Business" found that the cost of capital has been roughly double what large Japanese firms face ever since the 1960s.

A Commerce Department study covering selected years found that our cost of capital was higher here than in Germany, France, or Japan. And a report by the Semiconductor Industry Association found that the Japanese success in semiconductors in the 1970s was due in large part to lower capital costs, not superior technology, and not necessarily lower labor costs.

Why are they so high—capital costs? A major reason is excessive Federal spending. The large Federal deficit takes up an enormous amount of the typical year's savings and is projected this year to take up a third or more of the year's savings in the U.S. economy. That is driving up the cost of capital.

Deficits have ranged from three-tenths to 4 percent of gross national product during the first 13 years of this deficit binge that we have been on, and they are forecast, according to the CBO, to be 5 percent through 1990.

In our opinion, and in the deliberations of the Commission, we found that the problem was not necessarily taxation, but the problem was spending. We found that spending runs about 24.3 percent of GNP, whereas taxes have amounted to 19.1 percent of GNP, and this has been the median for all the years since our last surplus year, 1969.

Of course, in 1981 Congress passed major tax cuts and also tried to cut spending. As you will recall, Mr. Chairman, in fiscal 1983 receipts were 1 billion higher than in 1981, but outlays were $139 billion higher. This is the problem that we need to address, and in my opinion nothing less than a hard freeze on total spending, to stay in place until the budget is balanced, will work.

If Congress could freeze outlays at the level the CBO estimates for this year, which is $938 billion, revenues would match outlays by 1988, even if no improvement in the economy occurred. In fact, I am convinced that the economy could easily surpass the CBO's projected growth path, and that revenues would outstrip spending well before the end of fiscal 1988.

A spending freeze would do several other items. It would lessen Federal competition with the private sector for scarce funds, it would send a strong signal to overseas, it would help reduce instability in currency markets, it would help the Federal Reserve maintain a stable moderate growth of the money supply.

In addition to the freeze, I believe that we need two tax changes. One is the elimination of over-taxation of corporate income and of capital gains. Right now, corporate income is taxed twice—once when the corporation makes it and once when it is passed out to the stockholders as dividends.

We also tax capital gains which arise from successful risk-taking. This folly is compounded by failing to distinguish between gains that only represent the effect of inflation and real gains. Investors make rational decisions when deciding when and how to invest their earnings, and the present capital gains tax does not adequately encourage investors to invest in companies that need affordable capital. Without adequate affordable capital, we will diminsh our ability to compete, to provide new jobs for our citizens, and to continue to enjoy the standard of living which America expects.

Many other countries have solved this problem by having either a corporate dividend deduction or a shareholder credit, and by excluding capital gains from taxation altogether.

The CHAIRMAN. Mr. Dent, it is good to have you back with us again.

Mr. DENT. Thank you, Mr. Chairman, it's nice to be here.

[Mr. Hardage's prepared statement follows:]

CAPITAL RESOURCES AND INDUSTRIAL COMPETITIVENESS

Statement to the Senate Finance Committee

By Samuel A. Hardage

Chairman of the Board
Hardage Enterprises
Wichita, Kansas
March 29, 1985

My name is Sam Hardage. I am chairman of Hardage Enterprises, an investment and development company based in Wichita, and I served as a member of the President's Commission on Industrial Competitiveness (PCIC) and of its Capital Resources Committee.

Thank you for this opportunity to testify. Because the Commission is so well represented today, I will concentrate on capital-related issues, specifically: the cost of capital, the effect of excess government spending on capital supply and cost, and the importance of cutting double taxation of corporate income and capital gains taxes.

The cost of capital receives much less attention from the press or public in this country than does the cost of labor. Yet capital is equally vital to our industrial competitiveness. Furthermore, it is a cost that we can and should want to reduce. In contrast, we do not want, nor can we hope, to compete by driving down wage rates to the level found in newly industrializing countries, or even in most of our established competitors. The only way to remain competitive, given our high wage rates, is to make our work force so productive that our <u>unit</u> costs, or the features and quality of our products, are superior. Having sufficient affordable capital is essential to achieve this goal.

For business to be able to afford capital, it must be available at low enough cost. Unfortunately, most U.S. business faces unacceptably high capital costs, especially in comparison to the cost of capital for our principal competitors. The Capital

Resources Committee reviewed several studies that reach this conclusion. One by George Hatsopoulos, called "High Cost of Capital: Handicap of American Business," found that the cost has been roughly double what large Japanese firms face, ever since the early 1960s. A Commerce Department study covering selected years found the cost of capital to be higher here than in Germany, France, or Japan. And a report by the Semiconductor Industry Association found that Japanese success in semiconductors in the 1970s was due in large part to lower capital costs, not superior technology.

Why are capital costs so high? A major reason is excessive federal spending. When the government persistently spends more than it takes in (and 15 straight years of red ink should satisfy anyone's definition of "persistent"), the supply of capital available to the private sector inevitably suffers. What funds remain will be more expensive than if the government lived within its means.

Unless Congress acts immediately to freeze spending, the squeeze on the private sector will get worse. Deficits, which ranged from 0.3 to 4.0% of gross national product (GNP) during the first 13 years of the deficit binge, will be at least 5% yearly through 1990, according to the baseline forecast of the Congressional Budget Office (CBO). That is enough to soak up a third or more of a typical year's savings in the U.S. economy, a luxury we certainly cannot afford.

Some people try to blame the 1981 tax cuts for these large deficit figures. But a quick glance at CBO's numbers show the fault lies entirely with spending. Taxes will amount to about 19.1% of GNP this year, the median for all the years since our last surplus year, 1969. Moreover, taxes as a share of GNP are projected to keep rising from 1986 through 1990.

Spending, on the other hand, is now at 24.3% of GNP, scarcely below its all-time high of two years ago. It is projected to keep rising relative to GNP and relative to tax receipts from 1986 through 1990.

Neither tax cuts nor tax increases have stopped the spending juggernaut. In 1981, Congress passed major tax cuts and also tried to cut spending. The next year it passed one of the largest tax increases in history and also tried to cut spending. What was the net result? In fiscal 1983, receipts were $1 billion higher than in 1981. Outlays were $139 billion higher. Of course, economic conditions had a lot to do with those figures, but the point remains that spending has zoomed upward, year in and year out.

Therefore, I believe nothing less than a hard freeze on total spending, to stay in place until the budget is balanced, will work. If Congress could freeze outlays at the level CBO estimates for this year, $938 billion, revenues would match outlays by 1988, even if no improvement in the economy occurred. In fact, I am convinced that the economy could easily surpass CBO's projected growth path if spending were stopped in its tracks, and that revenues would outstrip spending well before the end of fiscal 1988.

A spending freeze would do more than lessen federal competition with the private sector for scarce funds. It would send the strongest possible signal to overseas, as well as domestic investors that the U.S. has the resolve to improve its competitiveness. That should help reduce instability in currency markets, which has contributed to both uncertainty and a high cost of capital for borrowers. Moreover, it should ease the burden of the Federal Reserve in maintaining stable, moderate growth of the money supply. If the Federal Reserve can maintain an even keel, another reason for high capital costs would disappear.

Finally, I would like to mention two tax changes that would greatly aid investment in productive capital and reduce our cost of capital, namely, elimination of the overtaxation of corporate income and of capital gains. Income from corporations is presently taxed twice, once at the corporate level as corporate income tax and once again when dividends are paid to the corporate stockholders. There is no excuse for singling out investments in corporations for an added level of tax, particularly when so much of the investment that makes us productive and competitive is undertaken by corporations. Studies by DRI and George Hatsopoulos, as well as testimony from economists show that elimination of double taxation of corporate income would have a dramatic effect on reducing our cost of capital.

It is also counterproductive to tax capital gains which arise from successful risk-taking. This folly is compounded by failing to distinguish between gains that only represent the effect of inflation and real gains. Investors make rational decisions when deciding when and how to invest their savings. The present capital gains tax does not adequately encourage investors to invest in companies that need affordable capital. Without adequate, affordable capital we will diminish our ability to compete, to provide new jobs for our citizens and to continue to enjoy the standard of living which America expects.

Most other advanced countries have addressed these problems by allowing a corporate dividend deduction or a shareholder credit, and by excluding capital gains from taxation altogether. It is high time the U.S. caught up with our trading partners in these respects. Both steps would encourage more investment and help lower the cost of capital. One need only track the rise in capital gains realizations and in venture capital investments following the 1978 and 1981 capital gains tax cuts to see the likely result.

To conclude, we should not try to drive down our hourly labor costs. Instead we should make labor more productive and get our equally important capital costs down by freezing government spending and removing the bias in the tax system against investment. We must take these positive actions if we are to insure the continuing improvement in the standard of living for all Americans. Without these changes, our ability to compete will continue to decline.

Thank you. I would be pleased to answer your questions.

Note: Kenneth D. Simonson assisted in the preparation of this statement.

STATEMENT OF FREDERICK B. DENT, COMMISSION MEMBER, PRESIDENT AND TREASURER, MAYFAIR MILLS, INC., ARCADIA, SC

Mr. DENT. I am Frederick B. Dent, President of Mayfair Mills of Spartanburg, SC.

I strongly endorse the conclusion of the President's Commission on Industrial Competitiveness that the industrial competitiveness of the United States has been declining and constitutes a threat to our standard of living if we do not constructively respond to the challenge.

The issues confronting us in this challenge involve not only the continuing increase in our standard of living but also our national security, world leadership position, and ultimately the success of the free world to preserve its free, democratic way of life.

The single clearest evidence of our weakened competitiveness is the $123 billion trade deficit recorded in 1984. Our trade in manufactured goods went from a surplus of $12.5 billion in 1980 to a deficit of $90 billion in 1984.

I believe the first indispensable step toward a restoration of industrial competitiveness is for the Federal budget deficit to be reduced significantly. I further urge that this be accomplished through expenditure reductions rather than through the alternative of income tax increases.

Of particular interest to this committee I believe is the Commission's recommendation that the President seek congressional advice and enactment of legislation establishing a cabinet-level Department of Trade. There is a need for the focused voice of a Federal trade spokesman, a need which has been brought about by the growth of an interdependent world economy. This recommendation does not look critically backward, rather constructively to the future in close alignment with our objective to continue increasing our standard of living.

In considering this recommendation we should recognize: increasingly greater trade deficits have occurred since 1975; imports make up an increasingly greater portion of our national consumption; exports have grown as a percentage of our domestic agricultural and manufacturing output; Far Eastern rim countries have emerged as our major trading partners as our trade focus has moved from the Atlantic to the Pacific; and we exist in a global economy.

Another area addressed by the Commission which has caused us competitive problems and great uncertainty in the recent past is the matter of export controls. Let me make clear that national security controls are not an issue. We should recognize the immense scope of this national activity. Approximately 140,000 export licenses were processed in 1984, at a cost to the Government of $30 million and a cost of $35–$40 million to private industry. Furthermore, one-third of this activity related to West-West trade controls.

The Commission believes that foreign policy controls should be used as a last resort, after exhausting diplomatic measures, and should only be applied if on a coordinated basis with our allies. We must be more pragmatic in our use of export controls, realizing that they have been very detrimental in undermining our Nation's image as a dependable trustworthy supplier, which is essential to long-term trading relationships.

The Commission also recognized the glaring need to strengthen the international trading system through intensification of preparatory work by the Government with industry, labor, and agricultural participation and consultation, working toward a future round of GATT negotiations aimed at addressing the key trade distorting issues of the coming decade.

There are broad perceptions of unfairness with respect to the international trading system across our economy, and it is a fact that GATT coverage today of trade barriers has diminished from 20 percent in 1950 to approximately 7 percent of trade barriers today.

We discussed the content of these negotiations.

Another important topic covered by the Commission recommendations involves U.S. antitrust policy. Our current antitrust policy was formulated at the beginning of this century with the objective of keeping our national markets competitive, free from monopolistic practices. It is time that they be revised to fully recognize the globalization of competition.

Other concerns of our Commission related to the maintenance of competitive export financing, the clarification of the Foreign Corrupt Practices Act.

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Mauer?

[Mr. Dent's prepared statement follows:]

STATEMENT OF
FREDERICK B. DENT, PRESIDENT
MAYFAIR MILLS, INC.
BEFORE
THE SENATE FINANCE COMMITTEE
MARCH 29, 1985

I am Frederick B. Dent, a resident of Spartanburg, South Carolina where I am President of Mayfair Mills, Inc. This firm is a textile manufacturer. I have been involved in manufacturing since 1946. Through corporate directorships I also have had experience with the steel, pulp, paper, lumber, consumer products, high technology and banking industries. For the four years 1973-77 I served at the Cabinet level of the federal government for two years as Secretary of Commerce and then through the confirming kindness of this Committee for two years as a Special Representative for Trade Negotiations. Thus my experience while heavily oriented to manufacturing also includes an exposure to national policy making and international relationships.

My presence here today stems from my service as a member of the President's Commission on Industrial Competitiveness which submitted its report to President Reagan on January 11th, 1985.

I strongly endorse the conclusion that the industrial competitiveness of the United States has been declining andconstitutes a threat to our standard of living if we do not constructively respond to the challenge.

This competitiveness problem is not one which has come upon us over a short period of time, but rather is the result of an accumulation of policies and trends that go back over at least two decades. The responsibility for this decline must be shared broadly by industry itself, the general public and the U.S. Government.

It is essential that national leadership recognizes this challenge and mobilizes public opinion in support of a commitment to correct it. Your holding of this hearing today is evidence of the sort of leadership and commitment required to accomplish this critical task.

The issues confronting us in this challenge involve not only the continuing increase in our standard of living, but also our national security, world leadership position and ultimately the success of the free world to preserve its free, democratic way of life.

The single clearest evidence of our weakened competitiveness is the $123.3 billion trade deficit recorded in 1984. Our trade in <u>manufactured</u> goods went from a surplus of $12.5 billion in 1980 to a deficit of $90 billion in 1984. Imports of manufactured goods made up 14% of the U.S. market for these products in 1982 and skyrocketed to 22% in 1984. On a bilateral basis our 1984 trade deficit in 1984 with Japan was $36.8 billion, $20.4 billion with Canada, $16.9 billion with EEC and $7.4 billion with Tiawan.

Further evidence of our declining competitiveness is in the lower rate of productivity per employed person in the United States during the 1960-83 year period as compared with major world competitors. Our productivity growth averaged 1.2% whereas the United Kingdom's growth rate was twice ours, West German's 2.8 times, France 3 times, the Republic of China 4.4 times and Japan's 4.9 times greater than our rate. A further threat to capital formation and the enhancement of our industrial competitiveness is found in the fact that the real return on capital in manufacturing since 1980 has fallen below the return obtainable through bonds. The difference in risks is clear and the direction in which investors seeking security and return without risk would go, is evident.

I believe that our current competitive situation is the result of our national complacency, over confidence and a failure to recognize that our economy over the years was becoming ever more inextricably interwoven with other national economies throughout the world. In many of these lands, particularly in the Far East, peoples were determined to improve their standard of living and to enjoy the benefits of a standard of living more closely attuned to that which they saw in the United States and other industrialized countries. The responsibility must be shared by virtually all segments of our economy and society.

The critical factor is that we now acknowledge the competitive challenge which confronts our nation and put our shoulders to the wheel. Much of what needs to be done rests in the private sector. Productivity is the responsibility of management and labor. Quality standards are set by management and are achieved by industrial teamwork. Customer service and satisfaction is the responsibility of those seeking to build job security. Incorporation of high technology developments into the manufacturing process is the responsibility of American management.

The general public has a part to play in this revival through recognition of the importance of industrial competitiveness to our national standard of living. Industrial competitiveness must be an important element in the policies which they seek to have implemented and it would not hurt if they emulated those in foreign lands who seek to support domestic industry when making purchases if they find all other factors virtually equal.

Government also has a vital role to play in the restoration of our industrial competitiveness for its responsibility includes establishment of the economic environment in which we operate, the maintenance of free and equitable markets both at home and internationally and the setting of priorities on our national agenda. In this forum it is logical for me to concentrate my remarks on governmental responsibility, but I want to make clear that the blame as well as the challenge is far from being limited to this forum.

I believe that the first indispensible step toward a restoration of industrial competitiveness is for the federal budget deficit to be reduced significantly. I further urge that this be accomplished through expenditure reductions rather than through the alternative of income tax increases. Attached are Exhibits I and II from a recent DRI study which indicate spending reductions will result in a significant increase in the rate of manufacturing investment by 1990 as compared with an income tax increase. The index of residential investment under similar circumstances would increase almost 200% and the rate of exports would advance over 400%. The bond rate of interest would decline significantly as would the mortgage commitment rate. Inflation would be significantly lower as would the dollar exchange rate.

I understand that the tax increases calculated in this study were 70% personal and 30% business amounting to $72 billion in year one, rising to $102 billion in year five. The expenditure cuts are in the same amounts but proportioned to the Grace Commission's recommendation by budget function. That is, 19% in military cuts, 31% in transfers, 26% in civilian compensation, and 24% in other non-defense discretionary programs. The cuts amount to 5% of total military spending, 5% of transfer payments and 16% of all non-military spending.

Of particular interest to this Committee I believe is the PCIC's recommendation that the President seek Congressional advice and enactment of legislation establishing a cabinet level Department of Trade. We recognize the complexity diversity and unfocused nature of our trade policy development and implementation as graphically outlined on Exhibits 3 and 4. These exhibits are included to demonstrate the need for the focused voice of a federal trade spokesman, a need which has been brought about by the growth of an international, interdependent world economy and its growing impact on the United States economy. This recommendation does not look critically behind, but rather constructively to the future in close alignment with our objective to continue increasing our standard of living.

Exhibit I
(DRI Study)

Economic Impact of Closing the Deficit through Budget Cuts
(Constant M1)

	1986	1987	1988	1989	1990
Real Output and Demands					
Gross National Product	-1.7	-1.7	-1.4	-1.0	-0.6
Industrial Production	-1.9	-1.7	-0.6	0.4	1.5
Potential GNP	0.0	-0.1	-0.1	0.0	0.2
Nonresidential Invest.	-0.5	-0.4	0.6	1.8	3.6
Residential Invest.	3.0	9.8	11.2	12.1	13.9
Exports	0.0	0.1	0.9	1.7	2.7
Imports	-0.9	-1.9	-2.2	-2.4	-2.7
Federal Purchases	-14.0	-13.6	-13.7	-13.6	-13.7
State & Local Purchases	0.2	-0.5	-0.8	-0.7	-0.6
Consumption	-1.1	-1.5	-1.5	-1.5	-1.5
Durables	-2.1	-2.5	-2.1	-1.8	-1.6
Key Indicators					
Manufacturing Employment (Millions)	-0.28	-0.28	-0.09	0.08	0.26
Manufacturing Investment	-0.3	1.2	4.2	7.5	11.3
Federal Funds Rate (% points)	-2.18	-2.96	-3.49	-4.13	-4.66
Corporate Bond Rate (% points)	-1.15	-2.42	-3.15	-3.58	-4.24
Mortgage Commitment Rate (% points)	-0.59	-1.53	-2.14	-2.61	-3.18
Nonborrowed Reserves	1.8	1.9	2.0	2.3	2.6
Money Supply (M1)	-0.1	-0.1	-0.1	-0.1	-0.1
Money Supply (M2)	1.1	2.4	3.9	5.5	7.2
Nominal GNP	-1.9	-2.3	-2.4	-2.5	-2.4
CPI	-0.2	-0.5	-0.9	-1.2	-1.5
Deflator for GNP	-0.2	-0.6	-1.1	-1.5	-1.8
Exchange Rate	-0.8	-1.8	-2.7	-4.2	-5.9
Labor Compensation	-0.5	-1.1	-1.7	-2.3	-2.7
Productivity	-0.1	-0.2	-0.2	-0.2	0.0

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Exhibit II
(DRI Study)

Figure 8
Economic Impact of Closing the Deficit
Through Income Tax Increases
(Constant M1)

	1986	1987	1988	1989	1990
Real Output and Demands					
Gross National Product	-0.6	-0.9	-0.9	-0.9	-0.9
Industrial Production	-0.8	-1.1	-0.7	-0.7	-0.7
Potential GNP	-0.1	-0.1	-0.2	-0.2	-0.2
Nonresidential Invest.	-0.4	-0.7	-0.5	-0.1	0.2
Residential Invest.	2.0	5.8	5.8	6.2	6.8
Exports	0.0	0.1	0.4	0.5	0.6
Imports	-0.7	-1.6	-2.0	-2.1	-2.2
Federal Purchases	0.0	0.0	0.0	0.0	0.0
State & Local Purchases	0.3	-0.1	-0.4	-0.5	-0.5
Consumption	-1.1	-1.7	-1.8	-2.0	-2.1
Durables	-2.3	-3.3	-3.5	-3.8	-4.1
Key Indicators					
Manufacturing Employment (Millions)	-0.13	-0.20	-0.13	-0.09	-0.07
Manufacturing Investment	-0.2	0.5	1.4	2.3	3.2
Federal Funds Rate (% points)	-1.41	-1.61	-1.81	-2.08	-2.16
Corporate Bond Rate (% points)	-0.52	-1.01	-1.17	-1.24	-1.30
Mortgage Commitment Rate (% points)	-0.27	-0.70	-0.89	-1.04	-1.18
Nonborrowed Reserves	1.3	1.2	1.3	1.5	1.5
Money Supply (M1)	0.0	0.0	0.1	0.1	0.2
Money Supply (M2)	0.6	1.2	1.8	2.4	2.9
Nominal GNP	-0.6	-1.0	-1.0	-1.0	-1.0
CPI	-0.1	-0.2	-0.2	-0.2	-0.2
Deflator for GNP	0.0	-0.1	-0.1	-0.1	-0.1
Exchange Rate	-0.3	-1.2	-1.1	-1.2	-1.4
Labor Compensation	-0.1	-0.3	-0.3	-0.3	-0.2
Productivity	0.0	-0.1	-0.1	-0.2	-0.2

Exhibit III

A Schematic of U.S. International Trade Policy Development

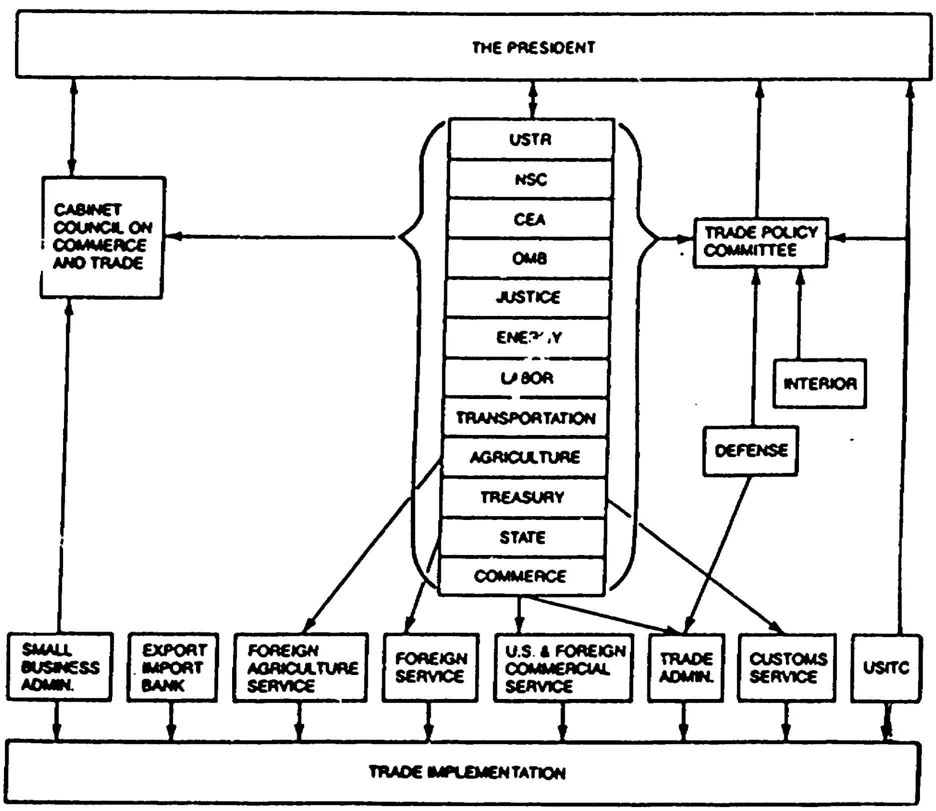
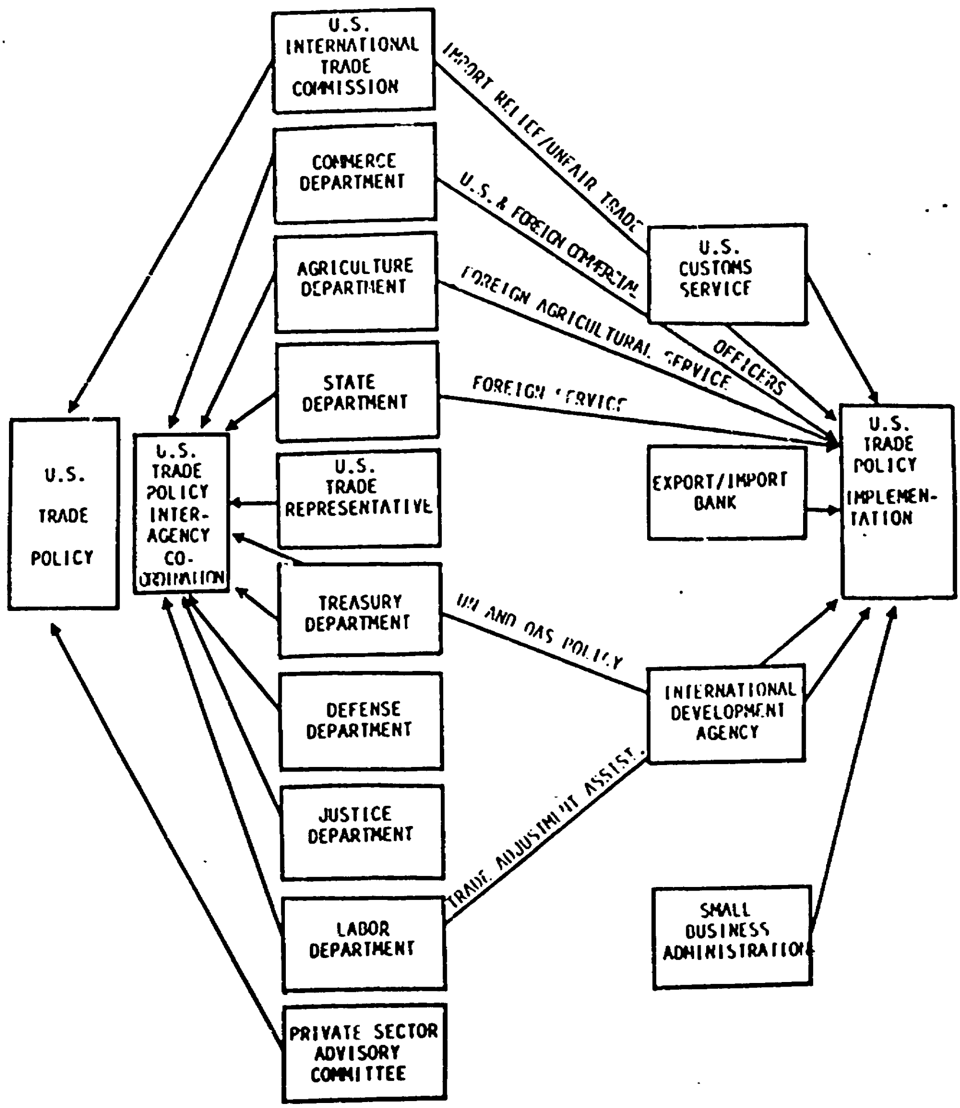


Exhibit IV

U.S. TRADE POLICY AND IMPLEMENTATION



In considering this recommendation we should recognize:

- Increasingly greater trade deficits have occurred since 1975.

- Imports make up an increasingly greater portion of our national consumption.

- Exports have grown as a percentage of our domestic agricultural and manufacturing output.

- Far Eastern rim countries have emerged as our major trading partners as our trade focus has moved from the Atlantic to the Pacific.

- We exist in a global economy.

As the only person to have served as both Secretary of Commerce and Special Representative for Trade Negotiations, I have confronted this issue with considerable misgivings, but believe that the interests of the nation are now closely attuned to the reorganization recommended by the Commission. I also believe that it is important for the resultant authorizing legislation to be the product of administration-Congressional consultation and I hope that this matter will have your early, serious attention.

This reorganization might ideally dovetail with another recommendation of the PCIC that a Cabinet Department of Science and Technology be organized to better focus our national policies in this area. This entity might absorb those elements of the current Department of Commerce related to science and technology such as the Patent Office, the National Atmospheric and Oceanic Administration, the Bureau of Standards, etc. While these two recommendations were not meant to be interdependent, I merely point out that they could be mutually supportive.

Another area addressed by PCIC which has caused us competitive problems and great uncertainty in the recent past is the matter of export controls. At the outset let me make clear that national security controls are not an issue. All agree that militarily useful technology and hardware should be kept from our adversaries to the fullest extent possible. However, at the same time we should recognize the immense scope of this national activity. Approximately 140,000 export licenses were processed in 1984 at a cost to the government of $30 million and a cost of $35-$40 million to private industry. Furthermore, one third of this activity related to West - West trade controls.

The PCIC believes that foreign policy controls should be used as a last resort after exhausting diplomatic measures and should only be applied if on a coordinated basis with our allies. It makes no sense for us to believe we are punishing a trading partner when alternative sources of comparable goods are readily available to them. We must be more pragmatic in our use of export controls realizing that they have been very detrimental in challenging our nation's image as a dependable, trustworthy supplier which is essential to long term trading relationships.

Another important topic covered by Commission recommendations involves U.S. Antitrust Policy. Our current Antitrust Policy was formulated at the beginning of this century with the objective of keeping our national market competitive and free from monopolistic practices. It is time that they be revised to fully recognize the globalization of competition and the need to refocus on world markets instead of merely domestic markets. The law needs changing particularly with respect to Section VII of the Clayton Act as well as other antitrust statutes and we also need to revise procedures. Antitrust activity has less interdepartmental and interagency input than most other policy development and enforcement functions. Others with responsibility for trade and commerce should be participants in antitrust actions. American business is the only one in the world confronted with the threat of treble damages which results in hesitation and uncertainty, deterrence to competitive strength.

The PCIC also addressed the need to expand U.S. trade. We recognize that 250 American firms account for nearly 85% of U.S. exports. With 25,000 other firms exporting to a very limited degree, there remain another 45,000 firms which are capable of exporting but are presently not involved. Presently there is discouragement and disarray in much of the exporting community due to the high value of the dollar, but governmental leadership must be poised to reemphasize export opportunities as soon as conditions change making American products more competitive worldwide.

Government leadership is required not only to make exporting a national goal, but we also need to recognize that we are the spending target for heavy export promotion expenditures by other countries. Our government gives moderate support to the export effort, but Great Britain, France, and Japan often spend three times as much as we do and as indicated much of this is directed to the United States market. We need to fight back with a well financed and well organized export promotion program. We need to recognize that our foreign commercial officers need time to develop familiarity with overseas markets, and we should give them longer than the normal two to four years rotation cycle in order for them to become better established.

Another deterent which many American businessmen mention with respect to exports is the Foreign Corrupt Practices Act and the uncertainties which it establishes with respect to the actions of a foreign agent, conflicting foreign legislation and account provisions. This along with the two U.S. antiboycott statutes should be clarified through new legislation in order to better set the stage for export emphasis.

Of interest to this Committee which in the Trade Act of 1974 pioneered the mandate of statutorily required private sector input into trade negotiations, I believe is the recommendation that the President is encouraged to appoint a Visiting Commercial Activity Review Team of leading U.S. business executives to evaluate export promotion activities in embassies in those nations that are the principal U.S. trading partners and report their findings to the President. The purpose of this recommendation is several fold:

- Further expand the public-private international trade policy development and implementation by permitting the private sector to audit embassy commercial activities.

- To serve notice to embassies and foreign service personnel that commercial responsibilities rank high on the priorities for their office.

- To utilize the experience and skills of our private sector to better focus and implement our overseas commerical activities.

It was anticipated that this evaluation would include checking on the attitudes of the local American Chamber of Commerce, individual American businessmen and local business organizations.

The PCIC also recognized the glaring need to strengthening the international trading system through intensification of preparatory work by the government with industry, labor and agricultural participation and consultation working toward a future round of GATT negotiations aimed at addressing the key trade distorting issues of the coming decade.

There are broad perceptions of unfairness with respect to the international trading system across our economy and it is also a fact that GATT coverage of trade barriers has diminished from 20% in 1950 to approximately 7% today. This has been brought about by a combination of changes in the make-up of the world economy evidenced by the growth of services, investment, counter trade, tax policies, etc. as well as the evasive tactics of certain countries to self serve their own trade interests. While the GATT is far from perfect, in my judgment it is the best hope for bringing equity to international trade and the United States must provide the leadership to strengthen the organization, although not at the sacrifice of our national interests.

The relatively high cost of capital to U.S. industry is another item which was flagged by PCIC for government attention. We all recognize that the cost of labor in the United States is far above that of our foreign competitors, but few of us realize that we also bear a burden of heavier capital costs which are also a competitive burden to be borne in globabl competition. It is estimated, for instance, that the cost of capital for Japanese firms during the 1961-1983 period was almost 50% lower than that of U.S. firms.

A significant contributor to this situation is our tax system which favors consumption over savings and investment. As a result, our savings rate as a percent of gross domestic product averages about 6% whereas Japan is in the 20% range with other international competitors falling in between although closer to the Japanese than ourselves as shown on Exhibit V.. Another contributor to this situation is the heavy web of regulatory policies which have engulfed American business in recent years in particular.

To overcome this bias against savings and investment, PCIC recommends greater reliance on taxation of consumption (but without abandoning progressivity) and by ending double taxation of corporate profits when received either as dividends or capital gains. These are important factors to be borne in mind as the Administration and Congress moves forward with plans to simplify our tax system. Simplification must also include a commitment to economic growth through savings and investment.

In conclusion, let me reiterate that my remarks today have focused on matters of mutual interest involving government policy which can enhance American industry's competitiveness. I have not dwelt on the actions which American industry itself can and is taking to supplement government action. However, if you will review the 1984 annual reports of American manufacturing concerns, I believe you will find, as I have, that all of them are commenting on efforts which they are making to increase productivity, quality and customer satisfaction. The corporate industrial world is vigorously responding to global competition and is yearning for complimentary governmental action. Unfortunately some of the industrial reactions involve foreign sourcing and moving manufacturing processes off-shore as the only viable responses to current global competitive pressures. I decry the harm which this does to the job security of American workers as well as the economic disruption which it causes to communities in our country. These are the reasons why we must vigorously address the issues of industrial competitiveness which I have discussed today and are further delineated in the PCIC report. This Committee's interest in the subject of industrial competitiveness is heartening. I hope that you fully appreciate the urgency of the crisis before us with record and growing federal budget and international trade deficits and take legislative action to restore our American economy to a secure basis for the future.

SAVINGS AS A PERCENT OF
DISPOSABLE PERSONAL INCOME

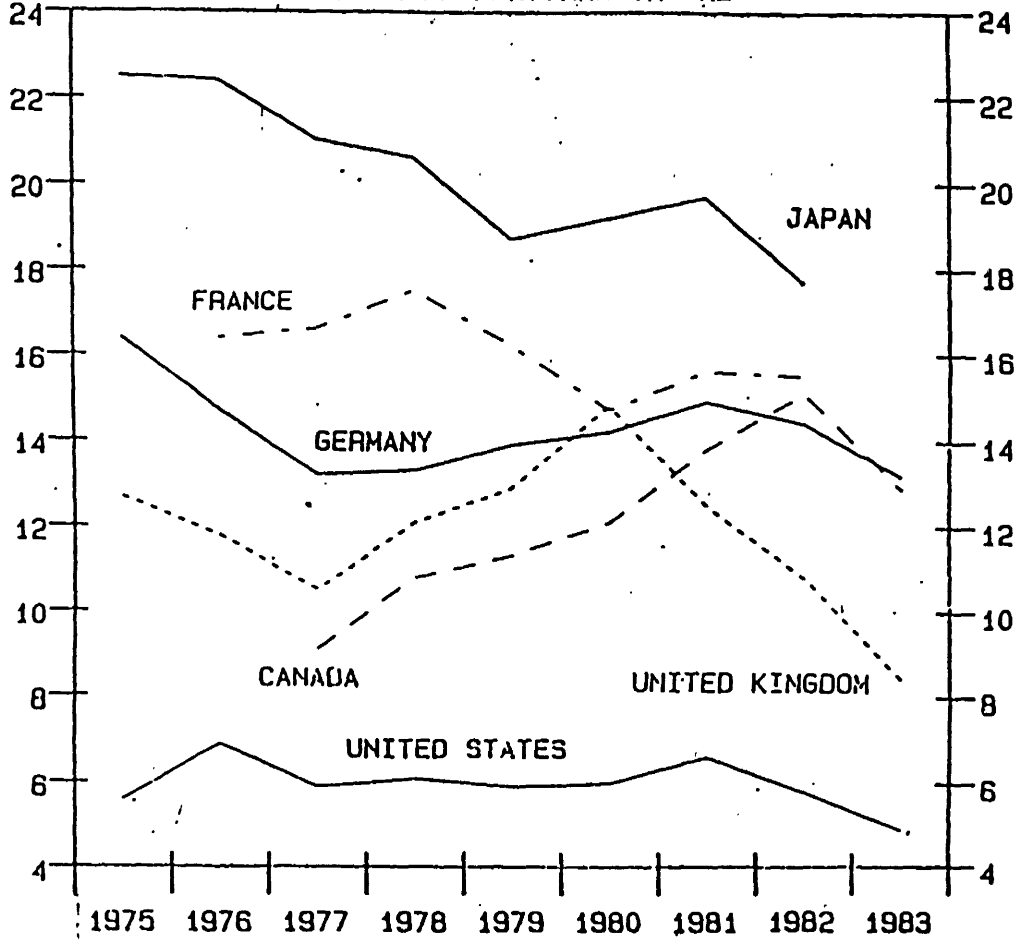


Exhibit V

STATEMENT OF BRUNO J. MAUER, COMMISSION MEMBER, PRESIDENT, RICKERT INDUSTRIES, MILWAUKEE, WI

Mr. MAUER. Mr. Chairman, my name is Bruno Mauer, president of Rickert Industries. Regarding the Commission, my particular area of interest was working on human resources and also as co-chairperson of the Task Force on Entrepreneurship and State Initiatives. For the sake of brevity, I will shorten my remarks a bit.

Unfortunately, our position reminds me of the fairy tale "Snow White." You may recall the antics of the wicked stepmother as she went through her incantations before the magic mirror. "Mirror, mirror on the wall, who is fairest of us all?". . . And every time, the magic mirror came up saying "You are." However, one day the mirror said, "Snow White." And the wicked stepmother became quite irate. And I think all of us are quite familiar with the rest of that story.

In a somewhat analogous fashion, the United States, too, for a lengthy period of time has now been playing "Mirror, mirror on the wall." In this case, we have been the fairest, even seemingly content—some might suggest self-righteous—for the answer kept coming back, correctly, "You are the fairest of them all."

However, the mirror has developed serious cracks and distortions. The voice is not so assuring. The answers are mixed, and the emotions and the concerns are running quite high.

We are not at the beginning, however; rather, we are decades into what the Commission has called global competition, the new reality. We have heard the mirror before, but only recently have we chosen to believe its answers have changed.

As you already know, international competition is dramatically impacting on many of our critical industries. I think this fact is now becoming well understood. Its base is broadening at an alarming rate, and by the time we are able to measure this competitive change, the momentum and impact to our system is extremely difficult to overcome. Frankly, for many of the industries, particularly those in our rust belt, it may already be too late, now we hear about the impact in our once safe and virtually immune high-tech areas.

So, let me share some of my observations resulting from the work on this Commission and on our task force:

The first—Japan is the most future-oriented nation in the world, planning, studying, and implementing.

Two: Japan has exhausted most of the valuable know-how of the West.

Three: Japan plans to be the world's economic leader by the end of this century.

Four: Japan has developed the capability in important technologies to realistically pursue the goal of world economic leadership.

Five: The key to becoming the world's economic leader is through the highest and best use of information, communications—including fiber optics, electronics, as well as employing the efficiencies created by robotics, flex manufacturing, process engineering, and the wiser use of human resources.

And six: Japanese success is an indication of a broader challenge, one that we will increasingly face as other nations of the Pacific rim become increasingly competitive.

If you feel this is just a bit too much, then let me share an observation made in 1983 by, James A. Baker, vice president of General Electric, their worldwide technical sector.

"The United States has three choices—automate, emigrate, or evaporate."

Rough, direct? Maybe. But I believe it is accurate, maybe even prophetic, for the problems are most certainly present, and the evidence of economic impact is seemingly growing worse by the day.

In my testimony today I do not wish to address the items already found in the Commission report, for it is already there for your deliberation. The material is well documented; the items urged for our Nation's course correction I believe are very clearly stated. And I encourage the Congress and the administration not to take this material lightly, for our very economic vitality is at stake.

There are other areas of major concern that we have worked on. Entrepreneurism—I believe it is a key missing link. A second area of major concern is State initiatives. I believe we need to understand that there are 50 States out there, and these 50 States are already deeply involved in this process of economic and competitive interests, and are already doing a great deal in this area of competitive position. We need to be aware of this diverse and essential activity.

The CHAIRMAN. Let me ask you a question on that.

Mr. MAUER. Yes, sir?

The CHAIRMAN. One of the great debates we always have in this Congress and before this committee is the taxability of industrial development bonds—which are, of course, a quasi-municipal bond but basically designed to attract industry. And there is no question that they cause the Treasury to lose money.

Yet, every one of our county commissioners and city councils and port district commissioners will come to us and say, "We need that so that we can attract industry" to wherever it is.

A counterargument to that is that this is basically robbing Peter to pay Paul; this is Asheville trying to take business from Madison, who is trying to take it from Denver, who is trying to take it from Portland. And from the net growth standpoint of the U.S. Government, it is no new business. Is that right?

Mr. MAUER. I think you are correct in that there are two very strong schools of thought in the area of IRB's, and how to deal with them.

The CHAIRMAN. Well, I guess this is my question: Are there businesses that would form because of an industrial development bond, that would not form for the lack of it? And I mean they would not form anyplace in this country but for an industrial development bond.

Mr. MAUER. My own personal feeling, Mr. Chairman, is they are massively misused and abused, and I would come from the school that senses that they are a specific inducement or incentive that is not a proper or ethical incentive.

Mr. HARDAGE. Mr. Chairman, if I might answer that or at least address that viewpoint, we have had considerable experience with the use of industrial revenue bonds and typically utilize four to six issues a year. I can personally state that in many instances I know of developments that have created jobs, that have created new tax bases, that would not have been there had it not been for the use of industrial revenue bonds. And we develop projects in 11 States currently so that's a pretty good broad-based amount.

The CHAIRMAN. But when you say "there," you mean they wouldn't be anyplace? They wouldn't form and organize and build a factory but for the bond?

Mr. HARDAGE. That is correct, sir. Now, I am talking about office buildings; I am talking about factories; I am talking about projects that create jobs and broaden the tax base.

I think the issue is broader than that, though, Mr. Chairman. I think it is the issue of the cost of capital and why do we need to have industrial revenue bonds in the first place? Because our cost of capital is so high in this country.

The CHAIRMAN. Let me get back to that, because I don't want to stray from this. I will get back to the cost of capital.

But I want to make sure that your contention is that these are businesses that they wouldn't create unless there was a market, would they? I don't care if there is an industrial development bond or not; you are not going to create a business if there is no market for your product.

Mr. HARDAGE. That is correct.

The CHAIRMAN. But you are saying that the cost of capital is so high that they cannot afford to form the business with the cost of capital where it is, but they can afford to do it with the industrial development bond. And this is not a question of 10 different cities competing for a business that is going to be created; it is a business that will not be created in any of the 10 cities but for an industrial development bond.

Mr. HARDAGE. I can testify that I personally know of at least a half a dozen examples over the last 4 or 5 years that would come under that category, yes, sir. It certainly would not be the case in all issues. I'm certain that General Motors has more than their share of capital, and I'm sure that they want to use industrial development bonds. But I know of examples that would fit into that category.

The CHAIRMAN. But there is a classic example. All of the cities and States that are bidding for the Saturn plant are holding out all kinds of blandishments, and I'll bet you there is a fair amount of industrial development bond offers in the proposals to General Motors. And I'll wager they would build that Saturn plant without any industrial development bond incentive. They are going to go someplace with that plant.

Mr. HARDAGE. Well, I think that's right, Mr. Chairman, but I think that GM or the Ace Manufacturing Co., that may be the smallest manufacturing company around, would not have to face that problem or ask those questions or search for that lowest cost financing if the cost of capital in general was lower to American business so they could afford to compete domestically and internationally.

The CHAIRMAN. Mr. Mauer?

Mr. MAUER. Mr. Chairman, in effect, it nets out to be an incentive and a redistribution scheme. I think that's the point that you were trying to make.

The CHAIRMAN. It is what?

Mr. MAUER. It nets out to be an incentive and a redistribution scheme.

The CHAIRMAN. What do you mean by that?

Mr. MAUER. The cost nets out to be the same in total; however, it is an incentive scheme in that certain industries will utilize or be encouraged or allowed to use IRS incentives.

The CHAIRMAN. No; by "redistribution" what do you mean?

Mr. MAUER. By redistribution I mean that if it nets out, then someone, somewhere in the system is going to pick up the costs to make up the difference.

The CHAIRMAN. Mr. Samuel?

[Mr. Mauer's prepared statement follows:]

REMARKS AND TESTIMONY

BEFORE:

SENATE COMMITTEE ON FINANCE

9:30 a.m. Friday 29 March 1985

Room SD-215

DIRKSON SENATE OFFICE BUILDING

SENATOR ROBERT PACKWOOD, PRESIDING

By:

Bruno J. Mauer, President
Rickert Industries
Milwaukee, WI. 53226
and
Member
National Commission on
Industrial Competitiveness

Mr. Chairman, during the past 18 months I have had the opportunity to serve this nation as a member of the National Commission on Industrial Competitiveness in a way that employs my avocation of some two decades, the study of economic competition among states and nations, It has been an enjoyable experience and I am appreciative of it.

The Commission on Industrial Competitiveness has brought together leaders from business, labor, government and academia. The members have examined our national competitive performance, evaluated its strengths and weaknesses, and through a process of sifting and winnowing and consensus building, arrived at some critical problems that must be addressed if we are to maintain our position as the world's economic leader. We have found evidence that in industry after industry, including our high technology sectors, the United States is rapidly losing world market share. In fact, we are being harder and harder pressed to find areas of our once dominant technology that are not being subjected to intense competitive pressure, or that in the near future will not be put to the test.

Unfortunately, our position reminds me of the fairy tale, "Snow White". You may well recall the antics of the wicked stepmother as she went thru her incantations before the magic mirror. "Mirror, mirror on the wall, who is fairest of us all?" And every time the magic mirror came up saying, "You are." But one day the mirror said "Snow White", and the wicked stepmother became irate. You know the rest of the story.

In a somewhat analogous fashion, the United States too for a lengthy period of time now has been playing the same game. In this case, we have been the fairest, even seemingly content, some might suggest self-righteous, for the answer kept coming back, "You are fairest of them all". Now the mirror is developing cracks. The voice is not so assuring. The answers are mixed, and the emotions and concerns are running high.

We are not at the beginning, however. Rather we are decades into what the Commission has called, Global Competition, The New Reality. We have heard the mirror before, but only recently have we chosen to believe its answer has changed.

As you already know, international competition is dramatically impacting many of our critical industries. Its base is broadening at an alarming rate, and by the time we are able to measure much of this change, the momentum is extremely difficult to overcome.........frankly, for many, already too late!

Let me share some of my observations resulting from work on this Commission:

1. Japan is the most future oriented nation in the world--planning, studying and implementing,

2. Japan has exhausted most of the valuable know-how of the West,

3. Japan plans to be the world's economic leader by the end of this century,

4. Japan has developed the capability in important technologies to realistically pursue the goal of world economic leadership.

5. The key to becoming the world's economic leader is through the highest and best use of information, communications, including fiber optics, electronics, as well as employing the efficiencies created by robotics, flex manufacturing, and wiser use of human resources.

6. Japanese success is indication of a broader challenge that we will be increasing face as other nations of the Pacific become increasingly competitive.

If you feel this is a bit too much, then let me share an observation made in 1983 by James A. Baker, a V.P. of General Electric and head of its worldwide technical sector, "U.S. business has three choices, automate, emigrate or evaporate." Rough, direct, maybe, but accurate-- even prophetic for the problems are most certainly present, and the evidence of economic impact seemingly growing worse by the day.

In my testimony today, I do not wish to address the items already found in the Commission report. It is already there for your deliberation. The material is well documented, the items urged for our nation's course correction clearly stated. And, I encourage the Congress and the Administration not to take this material lightly for our economic vitality is at stake.

Let me briefly note three points that I feel are essential to our economic revitalization, though not within the clear purview of the Commission's charge:

1. Entrepreneurialism, the missing link,
2. State Initiatives,
3. If we don't?

1. Entrepreneurs have been labeled the "missing link" in capitalism by George Gilder in his new book, "The Spirit of Enterprise". Gilder makes the valid and critical point that we have virtually overlooked this component of our economy as a critical resource upon which to draw, and that this resource may well be our greatest resource for boosting productivity, expanding job opportunities and creating new wealth.

   The Commission Task Force on State and Local Initiatives gathered some of the leading minds on entrepreneurial activity in a roundtable discussion. Frankly, we concluded it to be one of the most uniquely American assets. Entrepreneurialism is one of the critical ingredients that could certainly make an even larger contribution to the question the Commission addressed, Industrial Competitiveness. The Task Force report, summarizing the roundtable, is entitled, "Entrepreneurship and Its Impact on the U.S. Economy." I commend it to your attention.

A second more policy oriented work summarizing our interest in the entrepreneurial process is, "Entrepreneurs and Intrapreneurs: The Environment Needed to Produce". This document was not formally published by the Commission, but will shortly appear as an article in the Wisconsin Business Forum. It covers much of my thinking by incorporating the cultural, informational, and opportunity factors that are requisite for a proper entrepreneurial climate.

2. Very little has been said about the work already going on in almost every state capitol. In addition, we find this activity multiplied in counties, localities, and through cooperative ventures with the private sector. These governmental units have felt the pangs of economic reality for some time. Across this nation, the mad scramble for comparative advantage has been growing by leaps and bounds. While this activity may well be outside the purview of the committee, it is a critical part of our nation's entire effort.

State, local and cooperative private interests are already deep into the economic melee. We need to know what is taking place there, what may be working, and how can we be of best use and help.

The Task Force on State and Local Initiatives working with SRI International put together a useful document on "Innovation in Industrial Competitiveness at the State Level." We hope this document will become a primer for activity and actions taking place at non-Federal levels throughout this nation. It is important to help the states review the economic competitive process, shorten the cycle and testing process, and enhance activity at a more productive level and in a shorter period of time. We would very much like to see this an ongoing effort, for the better informed we are, the more competitive we become. Much of our competitive success will be based upon our ability to inform, share, and disperse this kind of information.

3. "If We Don't?"

Few want to hear or even discuss this subject. Yet, we must for we are there! My own sense is that we are not only failing to hold our own in world markets, but we are entering a period where blinders are more comfortable than reality. So, we ignore those policy alternatives I call economic course corrections that may be difficult, though necessary. We have done so well for so long that we now fail to realize the economic reality of the rapidly growing competitive globe, particularly, the Southeast Asian basin and perimeter.

Failure to successfully address our competitive problems ultimately means a reduction in our standard of living. That is the consequence, the penalty to be extracted for failure. So, unless our legacy is to be one of lowered expectations, narrowing opportunity, downward mobility, and increasing internal conflict, we must act.

I believe it is imperative that we recognize the great possibility of the downside, for if we continue to play charades with reality, the cost and consequence for both present and future generations of Americans can and will be devastating. The questions we need to ask are difficult. But--

What if we are not able to cap expenditures and budget growth?

What if we do not find reasonable ways to allow capital to flow at reasonable and competitive rates in world markets?

What if deficits in our trade balance continue to grow?

What if our productivity remains virtually stagnant while that of others continues to grow?

What if the technology gap continues to narrow and we lose much of our leading edge?

What if we fail to continue to loosen the grip on strangling regulation, and find comfort and temporary solace in quotas, tariffs, and the re-regulation of industry?

We must recognize that much of the world is now hard at work emulating our historical success. Frankly, some of them have learned well. They apparently remember much better than we, for a great part of our problem is that we have forgotten much.

This nation must recognize the reality of the new and competitive world marketplace. We need to know that it is a living, moving, vibrant world with great rising hopes and expectations. And we need to know the possibility exists that we either cannot or will not move to improve our economic competitiveness fast enough to offset what competing nations have accomplished. Ignoring this possibility misses the opportunity to accelerate needed change and avoid the responsibility we each have to our nation's critical economic needs.

We have the challenge and the opportunity of a lifetime........most likely, the most difficult many of us will ever face. Can we respond? Yes! Will we have the willingness, the tenacity, and the sense of urgency to do so? That is the critical question! "Mirror, mirror on the wall, who will be fairest of us all?"

STATEMENT OF HOWARD D. SAMUEL, COMMISSION MEMBER, PRESIDENT OF INDUSTRIAL UNION DEPARTMENT, AFL-CIO, WASHINGTON, DC

Mr. SAMUEL. Thank you.

I appreciate the opportunity, on behalf of the Industrial Union Department as well as of the President's Commission, of appearing before this committee. As one of only three Commissioners representing labor, I hope I may be excused for viewing the Commission report with a special perspective. For us and for our members, the ultimate significance of the Commission's work was jobs—the number of jobs, the quality of jobs, the income produced by jobs.

In short, this Commission dealt with the lifeblood of organized labor and of America's working men and women.

The Industrial Union Department represents particularly those unions in the manufacturing sector, many of which have been hard hit by the twin blows of recession and international competition.

I congratulate the President's Commission, therefore, for perhaps the most significant of its conclusions, that America's industrial sector is indeed in long-term trouble and in need of help.

For those of us on the firing line of the industrial sector representing unemployed workers in almost every manufacturing industry, this conclusion seems rather obvious. But as you are undoubtedly aware, there have been some prophets who have insisted, despite all the evidence to the contrary, that given the end of the recession and eventually the return of the dollar to more rational levels, Humpty Dumpty will miraculously reassemble himself and hop back on the fence, as good as ever.

Two decades of decline in profits, in earnings, in lost market share, proved to the Commission as it has to us in the labor movement that it will take more than a cheap dollar to put Humpty

Dumpty back together again, and that in fact America's lost competitiveness will need more than scissors and paste to restore.

The second aspect of the Commission's report I would like to emphasize is its definition of competitiveness. We in the labor movement have heard a lot from those who claim that our wage levels have priced us out of the international marketplace. In the first place, this is simply not the fact; the Commission acknowledged that workers' earnings have not kept pace with the cost of living for about a dozen years. But more important, the Commission makes it clear that the goal of competitiveness is not to lower our standard of living but rather to maintain a standard of living which is the keystone of our economy.

A third aspect is the Commission's eminently practical approach to the problem of international trade. All of us are fully aware that the United States is now in the global marketplace to stay. The Smoot-Hawley type of protectionism is no longer an option. But we are equally aware that we and our major trading partners are not playing the trading game by the same rules. We are still prattling about Ricardo's theory of comparative advantage. Our trading partners have been following Clausewitz on war. [Laughter.]

The Commission has made a number of recommendations which might restore that mythical level playing field we all dream about but which seems forever beyond our grasp. Although I am not enthusiastic about all of the Commission recommendations, at least those dealing with modernizing U.S. laws dealing with unfair trade practices and with relief for impacted industries deserve careful consideration by Congress and the administration.

Finally, let me conclude with a few words about the recommendations of the Commission subcommittee which I co-chaired, dealing with human resources.

The Commission recognized that technological change was inevitable in the world economy we now find ourselves part of, and unless our labor force was able to handle the new technology we would fall hopelessly behind. So we made a number of suggestions relating to education, training and retraining—none of which were novel but few of which have received the attention they deserve.

We also recognized that unless we could meet the needs of those dislocated by change, they would become an anchor slowing down our ability to compete in a fast-changing marketplace.

The needs of the dislocated worker are not being met now. It is a bitter irony that the administration today opposes continuing extended unemployment benefits for the some 325,000 long-term unemployed.

The Commission makes a number of suggestions, including strengthening the Employment Service and its programs, and advance notification of plant closings, which would help to improve the situation.

Finally, the Commission recommended that we would better understand our current predicament if representatives of business, labor, and management, and Government would sit down together in the same room and exchange information and ideas on a regular basis. Today, because we have no framework for such a meeting of minds, we recommend that Government examine its present system of advisory committees, or perhaps devise some other structure to accomplish the same purpose.

This recommendation, too, is a little like voting for motherhood; but in fact it is a necessary first step which other nations adopted long ago, and we should have.

In short, the Commission's recommendations, while being far ahead of the United States as a whole, still lag far behind most of our foreign competitors. But its report at least gives us some suggestions as to what is wrong and how to catch up.

[Mr. Samuel's prepared statement follows:]

Statement of the Industrial Union Department, AFL-CIO

By Howard D. Samuel, President

On International Competitiveness

Before the Committee on Finance

United States Senate

March 29, 1985

Industrial Union Department, AFL-CIO
815 Sixteenth Street, N.W., Washington, D.C. 20006
202/842-7800
Howard D. Samuel, *President*
Elmer Chatak, *Secretary-Treasurer*

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About IUD

The Industrial Union Department is the largest of the AFL-CIO's constitutional departments, with 57 affiliated unions representing 5½ million members.

As a constitutional department, IUD is a semi-autonomous branch of the AFL-CIO. The department is financed directly by per capita payments from its affiliates. It is directed by a president and a secretary-treasurer who are elected at biennial conventions. The governing body is an executive council composed of the two officers and 24 members, who are principal officers of affiliated unions.

History

The IUD stems from the 1955 merger agreement between the AFL and the CIO, which provided for a new industrial union department within the merged federation. Walter Reuther, then CIO and UAW president, was elected its first president.

Reuther was succeeded in 1968 by I.W. Abel, president of the United Steelworkers of America, who served until 1977. Jacob Clayman succeeded Abel for one term, until 1979, when Howard D. Samuel was elected president and Elmer Chatak, secretary-treasurer. Clayman had served as IUD secretary-treasurer from 1975 to 1977. James Carey, former IUE president and CIO secretarial treasurer, was the department's first secretary-treasurer, in office from 1955 to 1965.

Function

From its inception, the function of IUD has been to provide support services to affiliated unions in those areas where they share common concerns and where special efforts are needed to supplement the work of individual unions and the AFL-CIO.

IUD has a tradition of working with coalitions to strengthen labor's position on key issues. The department helped create the OSHA/Environmental Network, the Full Employment Action Council, the Consumer Federation of America, and a number of others.

Programs

Organizing – More than one-third of IUD's resources are devoted to organizing. The department initiated the concept of cooperative organizing under then President Reuther in 1963, and has provided major support for many organizing campaigns since then. Under this approach, unions assign their organizers to work under the direction of an IUD coordinator. The method encourages cooperation among affiliates through the pooling of available resources and virtually eliminates jurisdictional disputes. The organizing section is located in Atlanta, Ga., with field offices in the Mid South and Southeast.

Coordinated Bargaining – Another hallmark of IUD is coordinated bargaining, which brings together different unions having contracts with the same company to give them stronger leverage at the bargaining table. More than 40 unions participate in 71 different company committees, involving about 2,200 bargaining units and three-quarters of a million workers.

Safety, Health & Environment – Ever since it played a leading role in passage of the 1970 Occupational Safety and Health Act, IUD has taken the initiative in the courts and in legislative battles to assure proper implementation of the law. Through its work with the OSHA/Environmental Network, the department also has helped defend environmental protections.

Economic Policy – IUD has responded to downturns in the economy by examining and calling attention to the long-term problems faced by America's industrial sector. The department is a prime mover in efforts to develop a national industrial policy for the U.S. that will revitalize the industrial sector.

International Trade – This area has been an important concern to IUD because of the enormous impact that the policies of foreign governments have on U.S. industries and industrial union members. IUD continues to develop analyses, educational efforts and legislative approaches to key areas of trade policy, often through coalition activities.

Pensions – IUD monitors regulatory and legislative activities that could affect the status of benefit plans negotiated by its affiliates. The investment policies of private pension plans are an area of special concern for the department, which publishes *Labor & Investments*, the principal publication in this field.

Howard D. Samuel
President

Howard D. Samuel's career in the labor movement has spanned more than 30 years, and culminated in his election as president of the IUD in September 1979. For most of the period 1949-77, he was associated with the Amalgamated Clothing Workers of America, first as an organizer, then assistant president and from 1966 as an international vice president. He directed the union's political and legislative activities and as head of its union label department coordinated the union's boycott campaigns.

From January 1977 until his election as IUD president, Samuel was deputy under secretary of labor, directing the U.S. Labor Department's International Labor Affairs Bureau.

Samuel has been active in politics, serving as a delegate to state and national Democratic conventions, and has served on several government commissions and on the boards of numerous community organizations. A graduate of Dartmouth College, he also co-authored two books on government.

Elmer Chatak
Secretary-Treasurer

Elected IUD secretary-treasurer in September 1979, Elmer Chatak is responsible for administering the financial affairs of the department as well as providing direction to its organizing and coordinated bargaining activities. Since 1951, he has been involved in union organizing campaigns, first on the CIO staff for five years, then with the United Steelworkers.

The USWA loaned Chatak to IUD in 1963 to serve as organizing coordinator for the Mid-Atlantic cooperative organizing campaign, directing a staff of 35 organizers from 20 unions. His win record of 153 of 197 campaigns covered 31,500 new members.

In 1968, Chatak returned to USWA to establish an organizing department and serve as the first director, a post he held until being elected IUD secretary-treasurer. During that period, about 3,000 bargaining units with over 250,000 workers were organized into the union.

Chatak was born on December 15, 1929, in Acmetonia, Pennsylvania.

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I appreciate the opportunity, on behalf of the Industrial Union Department (AFL-CIO) as well as of the President's Commission, to appear before this Committee. As one of only three Commissioners representing organized labor, I hope I may be excused for viewing the Commission report with a special perspective. For us, and for our members, the ultimate significance of the Commission's work was jobs: the number of jobs, the quality of the jobs, the income produced by the jobs.

In short, this Commission dealt with the lifeblood of organized labor, and of America's working men and women.

The Industrial Union Department represents particularly those unions in the manufacturing sector, many of which have been hard hit by the twin blows of recession and international competition. I congratulate the President's Commission, therefore, for perhaps the most significant of its conclusions, that America's industrial sector is indeed in long-term trouble, and in need of help.

For those of us on the firing line of the industrial sector, representing unemployed workers in almost every manufacturing industry, this conclusion seems rather obvious. But as you are undoubtedly aware, there have been some prophets who have insisted--despite all the evidence to the contrary--that given the end of the recession and eventually the return of the dollar to more rational levels, Humpty-Dumpty will miraculously reassemble himself and hop back on the fence, as good as ever.

Two decades of decline, in profits, in earnings, in lost market share, proved to the Commission, as it has to us in the labor movement, that it will take more than a cheap dollar to put Humpty-Dumpty together, and that in fact America's lost competitiveness will need more than scissors and paste to restore.

The second aspect of the Commission's report I would would like to emphasize is its definition of competitiveness. We in the labor movement have heard a lot from those who claim that our wage levels have priced us out of the international marketplace. In the first place, this is simply not the fact; the Commission acknowledges that workers' earnings have not kept pace with the cost of living for about a dozen years. But more important, the Commission makes it clear that the goal of competitiveness is not to compete by lowering our standard of living, but rather to maintain a standard of living which is the keystone of our economy.

A third aspect is the Commission's eminently practical approach to the problem of international trade. All of us are fully aware that the United States is now in the global marketplace to stay; the Smoot-Hawley type of protectionism is no longer an option. But we are equally aware that we and our major trading partners are not playing the trading game by the same rules.

We are still prattling about Ricardo's theory of comparative advantage. Our trading partners have been following Clausewitz on war.

The Commission has made a number of recommendations which might restore that mythical level playing field we all dream about--but which seems forever beyond our grasp. Although I am not enthusiastic about all the recommendations, at least those dealing with modernizing U.S. laws dealing with unfair trading practices and with relief for impacted industries deserve careful consideration by Congress and the Administration.

Finally, let me conclude with a few words about the recommendations of the Commission subcommittee which I co-chaired, dealing with human resources.

The Commisssion recognized that technological change was inevitable in the world economy we now find ourselves part of, and unless our labor force was able to handle the new technology, we would fall hopelessly behind. So we made a number of suggestions relating to education, training and retraining--none of which were novel, but few of which have received the attention they deserve.

We also recognized that unless we could meet the needs of those dislocated by change, they would become an anchor slowing down our ability to compete in a fast-changing marketplace. The needs of the dislocated worker are not being met now; it is a bitter irony that the Administration even opposes continuing extended unemployment benefits for the 325,000 long-term unemployed. The Commission makes a number of suggestions, including strengthening the Employment Service and its programs, and advance notification of plant closings, which would help to improve the situation.

The Commission came out forthrightly in behalf of cooperation between labor and management. Not much of a surprise, you might suggest; almost like voting for motherhood or apple pie. But remember that this Administration's first act in the labor-management relations field was to fire all the air traffic controllers; and a number of major companies--Phelps Dodge, Louisiana Pacific, Continental Airlines, to name a few--had distinguished themselves by labor-management policies which could not be described as cooperative. So the Commission's recomendation is worth the paper it's printed on.

Finally, the Commission recommended that we would better understand our current predicament if representatives of business, labor and management could sit down together in the same room and exchange information and ideas on a regular basis. Today, because we have no framework for such a meeting of minds, we recommend that government examine its present system of advisory committees, or perhaps devise some other structure to accomplish the same purpose

This recommendation, too, is a little like voting for motherhood, but in fact it is a necessary first step which other nations adopted long ago and we should have.

In short, the Commission, while being far ahead of the United States as a whole, still lags far behind most of our foreign competitors. But its report at least gives us some suggestions on what's wrong and how to catch up.

The CHAIRMAN. Let me ask the other members of the panel if you agree with Mr. Hardage's testimony that two of the things we need to do is eliminate the double taxation of dividends and eliminate the capital gains tax.

Let me start with you, Mr. Mauer.

Mr. MAUER. Yes, sir. I would strongly feel that the reduction of capital gains is a tremendous incentive in the system, and particularly from my perspective, the entrepreneurial one. A great deal of additional innovation, job creation, that whole fermenting process, then has the opportunity to take place.

We now look back to when the rules on capital gains taxation were lowered—an additional incentive was built into the system. The results, a great deal of additional entrepreneurial activity has taken place in the system, a lot of new job creation, new ventures and product and service innovation and creation.

The CHAIRMAN. Let me stop there. For the moment I just wanted to know if you agreed with him.

Mr. MAUER. Yes, sir, I agree with him.

The CHAIRMAN. All right.

Mr. Dent?

Mr. DENT. Yes, it would certainly stimulate economic activity and job creation in this country.

The CHAIRMAN. Mr. Samuel?

Mr. SAMUEL. I think the jury is still out, Senator. The fact is that I'm sure it has led to some increase in productivity and production;

on the other hand, we are very disturbed that major needs of this country are not being met because of the shortfall in income to the Government. And surely that shortfall, as you know, is predominately from the corporate sector, contributing less and less to the needs of our country.

The CHAIRMAN. Now let me ask a second question:

If we were to eliminate the double taxation of dividends and to eliminate the capital gains tax, over the next 5 years would you expect that those two items would increase or decrease Government revenue?

Again, I will start with Mr. Mauer.

Mr. MAUER. Good question. My own feeling is that we need to go for the long pull. However you have to overcome the negative momentum of many years of prior indulgence. So early on, the direction and use of that capital flowing through the system, begins to move toward highest and best use.

Yes, I think that within a reasonable period of time that private sector productivity, job creation, and enhancement of our ability to compete in world markets will certainly take place.

The CHAIRMAN. Mr. Hardage?

Mr. HARDAGE. We asked this question of many economists that testified before our Capital Committee over the year and a half, Mr. Chairman, and the conclusion was that there would be some revenue loss for the first 1, 2, or possibly even 3 years, depending on the economic model that you use, depending upon the assumptions. But after that it would be a tremendous positive net generator of funds, mainly because of the time it would take.

The CHAIRMAN. I assume immediately, at least on capital gains which produces about $11 billion a year, immediately it has got to be some loss. You are not going to pick up $11 billion immediately by eliminating the capital gains tax.

Mr. HARDAGE. Well, not necessarily, Senator. If you will recall, we had a capital gains deduction some years ago, and there was an enormous increase in taxes rather than a decrease in taxes. There was a projected decrease in tax revenue, but what happened was there was an actual increase.

The CHAIRMAN. As a matter of fact, there wasn't an enormous increase. It has gone, from 1978 to now in capital gains taxes, in a margin of roughly $11 to $13 billion. But that is in terms of inflated dollars. If you mean in terms of constant dollars, the capital gains tax has gone down since we made the cuts.

Mr. HARDAGE. Well, there is one disincentive that we have right now in the system, now that you talk about real dollars, Mr. Chairman, in that someone who made an investment of a million dollars 10 years ago and now it's worth $2 million, they have theoretically a million dollar capital gains. But in reality, because of the time-value of money, they don't have a gain; and I think that a lot of those gains that are sort of sitting in the closet, that are paper gains but not real gains, would in essence come out of the closet if taxation of capital gains were eliminated. It would certainly put us on a foundation with other countries.

Mr. DENT. Mr. Chairman, with our financial condition the way it is today, I would not vote in favor of cutting taxes on anything. We simply cannot afford, in the face of projected greater budget deficits in the years ahead, to cut taxes.

Now, on the other hand, if we had taken fiscal action where we were in a position where taxes could be cut, then I think we could derive favorable benefits such as you have outlined. But I don't think under current circumstances when our position is so tenuous that we should consider cutting any taxes.

The CHAIRMAN. Mr. Samuel?

Mr. SAMUEL. I share Mr. Dent's thoughts on it.

The CHAIRMAN. Bill?

Senator BRADLEY. Thank you very much, Mr. Chairman.

I want to welcome the panel, and I appreciate your testimony.

What I would like to ask you is, do you believe that in order to enhance our competitiveness generally, that we have to be prepared to embrace change as a society? Change in the form of technological change, in the form of international competition? Would your general feeling be that we should resist that change, or that we should embrace it and try to shape it so that we maximize our potential for economic growth?

Mr. DENT. Senator, the net recommendation of the Commission is that private industry, the public, and the Government must all in their own ways not only recognize the essentiality of facing up to our need to increase competitiveness and make it a national priority, but also to change in our various areas the ways we have done business. We can no longer look over our shoulder at the new global day. We have got to change immediately.

Senator BRADLEY. Mr. Mauer?

Mr. MAUER. Senator, I would like to suggest that we are in change. We are in a rapid state of change. We are in change right now. And if you take a look at what is happening in world competitive environments and the impact on our domestic private sector today, you'll know that we are in a rapid state of change. We are being challenged virtually on every front.

In my own State, the industries are running as fast as they can to find methodologies, ways if you will, of looking at themselves, their own management style, their employees, their costs, their competitive markets, and the whole host of criteria that go into this process called change.

We are taking a look at our educational environment today from grade schools to high schools—and into our universities, and we see immense amounts of change there taking place today.

So we are in times of change, and even greater change will need take place. Frankly, I don't see us having, very many alternatives, if we are going to meet the test of world markets.

Senator BRADLEY. Anyone else on the panel? Mr. Samuel?

Mr. SAMUEL. Well, I think to a certain extent I agree with both of the other two panelists who have spoken, Senator Bradley. We are in the midst of a period of change which we will have to accommodate to.

It seems to me, however, that what we have failed to do is to make sure that we adjust to the change in ways that are beneficent to the majority of the people of the country. One of the points we make very strongly, for example, in the section on human relations, is the fact that the penalties of dislocation seem to fall unduly on a very limited part of our society, mostly working people, the disadvantaged, those who are not well-trained, the elderly, and so forth. That group tends to act as a drag on change. If we did a better job of allowing them to accommodate, to adapt, to adjust, surely we could accommodate change much more rapidly than we are now.

Senator BRADLEY. Well, isn't that the point?

And I would like to have your other opinions on the point that Mr. Samuel made, which is essentially that, as you said, Mr. Mauer, we are in a state of change. Things are changing. The question is only, are we going to keep up with it and maximize our country's potential to accommodate that change?

If you just take one of our sectors, like manufacturing, we get about 25 percent of our GNP from manufacturing this year. By the year 2000 we will continue to get 25 percent of our GNP from manufacturing, but many people estimate it will be done with 15 million fewer workers. So the question is, what happens to those workers? What kind of policy must we have to accommodate the legitimate concerns of those workers for their health benefits, for pensions, for a chance to continue to earn a living for their family? I mean, this is the central question for our political economy if we are going to be able to adjust to change.

Is that not correct? And what are your views as to how we answer their very legitimate concerns about their long-term economic health and their families' long-term economic health?

Mr. HARDAGE. Senator Bradley, the Commission was very concerned about the ability to change. I think this was one of the major thrusts of the Commission, that we wanted to address the whole issue of being able to compete in the world economy. And as Chairman Young said in earlier testimony, 70 percent of all the products manufactured in this country have to compete with foreign competition, foreign products.

We need to make the playing field more level in the sense that our tax disadvantage vis-a-vis our competitors' is lessened, regulations are lessened, all of the problems that our companies and our industry faces in competing, so that we can move forward to create those new jobs.

If we can't compete, Senator Bradley, we are going to see the standard of living in this country decline. No one on the Commission recommended lowering our wage rates. The thrust of the Commission is how are we going to continue to enjoy the growth in the standard of living which we have always enjoyed in the past.

If we can't compete, and you have touched to the central issue of the theme of the Commission, if we cannot compete, then we are not going to be able to see a continuation in the growth of that standard of living, and that's important for every single American.

Senator BRADLEY. Mr. Chairman, I heard the buzzer. May I followup?

The Chairman. There is only the two of us, and we have plenty of time; why don't you go ahead, Bill?

Senator BRADLEY. OK.

But what about the workers? I heard what you said, and I agree with the general thrust, but what about the workers who are facing the loss of their jobs, many of them 45-50 years old? What happens to them? And what responsibility does Government have? And what responsibility does the private sector have? What responsibility does the export sector have?

Mr. DENT. Senator, I think you are hitting right at the crux of the question. I think we need to look at the United States, where today we are taking about 33 percent of GNP for Governments at all levels, versus Europe, which thought that the central Government could answer the questions that you have raised. As a result, while we have created 22 million jobs since 1970, they have actually lost jobs. They have been unable to meet change because they have tried to do it from a central focus in Government. And that same thing will happen to us if we leave the questions to be solved by Washington.

What we need to do is to turn back to the private sector, which is creative and adaptive to change. Set some guidelines where they can take care of these people and create new and better jobs.

Senator BRADLEY. Who sets the guidelines?

Mr. DENT. General public opinion, discussion between labor, industry, and Government.

Senator BRADLEY. Well, OK. I hear that frequently in the debate about how to deal with these problems. OK.

You say you don't want the Government involved, and so we set guidelines that are formed by public opinion that are built up because of the relationship between Government, business, and labor. Well, how does that all happen?

I mean, let's live in a real world where people lose their jobs as each year goes by, as we lose our competitiveness. Whose responsibility is it? Maybe I am not seeing something here.

Mr. DENT. I have just spent a day and a half in Washington meeting with European counterparts in business and industry, and they are stultified, because they have depended upon bureaucracy to answer all of these questions, and they have consumed most of the free capital that was available in those countries. And they are dead in the water.

Now, we have got to use more of the private sector to solve it and limit the percentage of GNP going through Government. That doesn't mean eliminate Government; it means to hold to a reasonable level and have standards set, and leave the private sector to achieve those goals.

The CHAIRMAN. Let me followup on this, if I might.

Your facts about the European Common Market are right, and it has been true for 30 years since they were founded in the mid-1950's. But the last 10 years are instructive.

You are absolutely right. We have created 19 million jobs in this country in the last 10 years. The Common Market is zero; they have created none. And yet, they have a higher rate of savings, collectively, than we do. And by and large as a rule of thumb, although they have higher total rates of taxation, they have lower rates of taxation as a rule of thumb on capital and income and higher rates on consumption.

How, if we are so disadvantaged—higher capital costs, higher taxes on capital, higher taxes on income—how have we managed to outdistance them in job creation?

The reason I use the comparison is, we are roughly the same populations, and we have had roughly the same population growth. And yet, they have not grown and we have.

Mr. Mauer?

Mr. MAUER. Mr. Chairman, you are talking about an area of very deep interest. It goes back to our job creating sector, the entrepreneurial activity, the start-ups, the innovative companies, that whole process according to the David Birch studies and several others, quite prominent on Capitol Hill now, that a sizeable percentage of the new jobs created come out of smaller business. Job creation is a byproduct of the entrepreneurial activity that is part of that cultural phenomena that we have encouraged in this country.

The CHAIRMAN. But how have we done it in the face of such an adverse saving situation and an adverse tax situation and an extraordinarily high deficit?

Mr. MAUER. Because of some of the interesting things that happen on the down side; for example, people who are working at jobs and recognize that they are either a dead-end job, or a job that may be changing or eliminated. This very process encourages a great deal of entrepreneurial activity. Therefore, adversity is often the initiator of entrepreneurial activity.

You also need to recognize the impact that the reduction in capital gains, the new flow of capital, some venture capital, along with other kinds of capital, had on the productive system. As we changed our tax laws, it encouraged the process of capital to flow to highest and best use in the system, and some of this capital flows into that smaller business spectrum where jobs, innovation, and creation takes place.

Mr. SAMUEL. May I comment on this?

Senator BRADLEY. Yes.

Mr. SAMUEL. I just want to make it plain that, despite—I am sorry to say this—the comments of previous panelists, the Commission's report is very clear on this, and is very clear that the Government does have a principal responsibility for meeting the needs of those who are sacrificed on the altar of change. And we make very specific recommendations regarding the Employment Service, regarding the role of adjustment policies for all workers, not just those impacted by international trade, by technological change and other causes, for training programs to make it possible for workers to resume their place in the labor force.

We have a strong recommendation that the Employment Service itself be changed and improved, that it is not performing its service now as a source of information about the labor market for the unemployed. As a matter of fact, there are very few jobs reported to it, and very few people get jobs through the Employment Service, which is really a terrible waste.

And plus some other recommendations which I mentioned here.

Senator BRADLEY. So that this report, the report of the President's Commission in Industrial Competitiveness, recommends that Government have responsibility for those workers who are displaced by the effects of change?

Mr. SAMUEL. Yes. We did not suggest—and I'm sorry to have to contradict Mr. Dent—that this come out of some kind of spontaneous generation of public opinion. As a matter of fact, if we depend on public opinion we will continue to have something like a million people unemployed which we have today and tremendous waste in our labor force in our machinery for trying to improve our labor force function.

The CHAIRMAN. Let me ask a followup question, because it is an issue that will be before us, relating to employer-financed education.

On page 35 of your report, you recommend "employer financed tuition should be permanently exempted from personal income taxation." Is that a recommendation that the entire panel agrees with?

Mr. SAMUEL. What page was that, Mr. Chairman?

The CHAIRMAN. Page 35. And the reason I say that, at the moment the law does not tax tuition paid for by employers when they send their employees off. Most of it is community college—it's lower level. Some of it is graduate school of science and engineering, but the bulk of it is at a lower level. But that law expires at the end of this year.

Mr. MAUER. That is correct.

The CHAIRMAN. And if it is not extended, all of those tuition payments are going to be taxed as income to the employee. We are curious if the recommendation of the panel is that that exclusion should be continued.

Mr. SAMUEL. It is, Mr. Chairman, because we realize that many workers who will require retraining do need retraining in different areas than they are now functioning. And this particular clause, when it expires, will penalize exactly those workers who probably have the greatest need of retraining.

If they upgrade in their present skills, then they get the tax exemption. If they are moved, and have to move, to a different skill, they have to pay the tax, which seems to be a catch-22.

The CHAIRMAN. An unusual anomaly.

If you are a vice president of a major corporation, there is probably hardly a course that you could take that wouldn't be job-related—probably. If you happen to have dropped out of high school at 16 and you are a janitor, but the employer would like to train you so you can work in the tool crib, that's to advance you, and therefore that counts as income to you. Therefore, the very people that you would like to help the most are the ones it discriminates against the most.

Senator BRADLEY. If I could, I would like to pursue this whole area of efficient allocation of capital. All of you have asked for—one says no capital gains, the other says incentive for savings. Isn't the real question to try to have in an internationally competitive marketplace the most efficient allocation of capital possible domestically?

Mr. HARDAGE. Senator Bradley, the Commission found that we were at a distinct disadvantage vis-a-vis our competition. And I would suggest that our real competition in the future is the Pacific Rim countries, more so than even Europe. Right now there is more trade that goes on in that direction than goes the other way.

But we found that we were at a distinct disadvantage with our competition because our cost of capital, in the case of Japan, was twice as high, and in the cost of our European competitors it was up to 70 percent as high.

Senator BRADLEY. But the cost of capital involves not simply tax policy, whatever your recommendation is on capital gains, but it also involves what the interest rates are.

So, the fact that the cost of capital is higher here than in Japan is much more a reflection of where our interest rate is as opposed to Japan than a relative difference in our tax systems.

But the point is not the cost of capital but efficient allocation of capital.

Now, as a proposition, do you agree that the best way to allocate capital in this country, in order to enhance our competitiveness, is to allow the market to allocate the capital—market forces?

Mr. HARDAGE. Yes, sir, we do. We believe that there should be a free market. But I would not agree with the statement that you made that the cost of capital is solely dependent upon interest rates. There is a significant cost of capital that is associated with the double taxation of corporate income. In fact, the single most dramatic change in the cost of capital that could be made, in the opinion of the Commission and the Capital Resources Committee—we heard testimony for a year and a half from economists, and there are several studies which have been done on this, and the DRI was one of them, that indicated that elimination of the double taxation of corporate income would have a dramatic effect on lowering the cost of capital in this country and making it more on a para-pursue basis with our competitors.

Senator BRADLEY. I know that was one of the recommendations, but I want you to focus on the proposition: Do you think the market is the most efficient allocator of capital?

Mr. HARDAGE. Absolutely.

Senator BRADLEY. You do?

Mr. HARDAGE. Yes, sir.

Senator BRADLEY. Do you, Mr. Mauer?

Mr. MAUER. Yes, I do—recognizing that capital is at least a three-legged stool. One is that initial cost of the capital, as you say "interest." But don't forget you also have the availability and the type of capital. So it isn't just cost of capital; it is the availability of capital as well. And the type of capital that you are dealing with. And frankly, in our Capital Committee we worked on a host of these kinds of problems, looking at the broad spectrum of capital and not just that initial cost.

Senator BRADLEY. What do you mean "type of capital?"

Mr. MAUER. You have equity, capital you have bond capital, you have a whole spectrum of available capital.

Senator BRADLEY. OK, you have various instruments.

Mr. MAUER. Instruments, that's correct.

Senator BRADLEY. OK. If you agree that the market should allocate capital and that that's the most efficient and most central to our international competitiveness, and we assumed away the cost of capital differential because of interest rates, and we focus only on tax policy, shouldn't all capital be taxed about the same? Why should some kind of capital be taxed at one rate and another taxed at another rate? Doesn't that distort the functioning of the marketplace?

Mr. HARDAGE. Well, if you are talking about taxing interest rate instruments one way and capital stock instruments another way, we agree with that. And the Capital Committee thought that there should be more neutrality in the treatment of income. And the Commission felt that there should be more neutrality.

Senator BRADLEY. OK. Now, let's focus on what "more neutrality" means. More neutrality in taxing capital income means a more similar tax rate for all kinds of investment instruments. Is that not correct?

Mr. MAUER. That's correct.

Senator BRADLEY. Is that not correct?

Mr. HARDAGE. Yes. The Commission had no quarrel with that.

Senator BRADLEY. So that means that you believe that, in order to have the most efficient allocation of capital possible—then I assume that is why you have also called for a simplified income tax—that the benefit of having a neutral treatment of capital, all capital treated at the same tax rate, would be better than the present tax system where you have one kind of capital treated at 50 percent and another capital treated at 20 percent and another capital not taxed at all, in this kind of crazy quilt of incentives that skews investment all over the place and prevents the market from allocating the capital. Is that not right?

Mr. MAUER. That is correct.

Mr. HARDAGE. That is correct, except that if it does not increase the cost of capital.

Mr. MAUER. Then maybe we shouldn't tax capital. [Laughter.]

Senator BRADLEY. I didn't lead us to the conclusion in that line.

The CHAIRMAN. I want to follow up, because I want to hear Mr. Hardage and the others respond to that.

You are then saying that taxes on capital gains should be treated exactly the same as taxes on any other kind of capital, because you specifically recommend going to zero on capital gains.

Mr. HARDAGE. Yes, sir, we recommend the elimination of taxation of capital gains.

We did not focus in, Senator Bradley and Mr. Chairman, on a specific tax proposal, because we know there are many tax proposals. But what we did agree is that there should be more neutrality, that we should strive for a tax system which lowers our cost of capital. And unless you do those things, you cannot lower our cost of capital vis-a-vis our competition. And if you don't lower our cost of capital, if we are going to compete, the only other way we are going to compete is to lower our cost of labor. And I don't think that any Senator would want to vote for lowering the wages of the working men and women of America.

Senator BRADLEY. Mr. Chairman, if I could, I think that that is—for whatever my opinion is worth—an intellectually honest position, and that is, you recommended capital not be taxed at all.

Mr. MAUER. That's correct.

Senator BRADLEY. But if it is taxed, all capital should be taxed about the same in order to improve the maximum neutrality of the system.

Mr. HARDAGE. But only if it lowers our cost of capital vis-a-vis our competition. This was a report on "Global Competition—a New Reality." And you talked about change, Senator. We need to address change, and we need to address the reality of change and if we don't compete effectively.

So we didn't recommend just making it neutral; we recommended that we needed to make the playing field more level in the United States, and we needed to make it more level in the international waters so we could compete with the Japans and Koreas and Singapores of the world.

The CHAIRMAN. I want to follow up with something to Bill, because what is happening here may be of more significance than you realize later on down the road. I want to know what you mean by capital in your definition of all capital should be taxed equally.

Senator BRADLEY. All investment instruments.

The CHAIRMAN. All investment instruments?

Senator BRADLEY. In other words, if you were operating in a perfect world, given what you said about the neutrality of capital, there would be one rate of tax on all kinds of capital instruments. Now, that means interest and dividends and capital gains, and all the variety of other instruments would have the same tax, which is what neutrality means if you are going to have any tax on it.

The CHAIRMAN. Well, that's what I wanted to make sure you meant, because then I think you are going to come to a totally different conclusion in terms of the formation of new businesses, from what Mr. Mauer thinks.

You talked about entrepreneurship.

Mr. MAUER. Yes, sir.

The CHAIRMAN. The Portland metropolitan area in Oregon has a pretty good fledgling light electronics industry. We were fortunate in having two or three large companies locate there, and they have spun off dozens of new companies.

In going through the companies and talking with the people who have founded them—35-40-45-year-old bright engineers, a fair number of them women—they left very good paying jobs at Intel or Hewlett-Packard or Tectronics to form their own company, and almost without exception when you ask them the kind of taxes that were the incentives for them, and what was most important and least important, they would not give you the answer that they wanted all capital taxed equally. For them, the level of the corporate profits tax and the double taxation on dividends was an almost insignificant factor in their decision to spin off and form a new business. The key factor was the taxation of capital gains and stock options. And if you were to tax all capital equally, they never would have formed their companies.

Mr. SAMUEL. Mr. Chairman, part of my response to that would be that we need to recognize that we have a broad spectrum of businesses that have various types of needs regarding capital, from the very small startup that you are addressing regarding your high tech in Portland to where maybe savings or investment or capital gains may or may not be important, to the very large corporations that possibly were the seed companies, frankly, out of which those smaller ones somehow came.

The CHAIRMAN. I will give you a specific example:

One of the four vice presidents of Tektronics, which is a company whose employment varies from, oh, 16,000 to 25,000 over the years depending on whether business is up or down, one of their four vice presidents who was probably on at least the competitive ladder to be president left and took a $3,000 a week salary cut and some very attractive stock options to go off and become president of a company with about 300 employees. And it had been going for about a year and a half, and it wasn't being well managed. He would not have done that—and the company probably would have folded, or that would be my hunch—he would not have done that but for the stock option and capital gains incentives. Period.

And in the other companies that were being formed, one of them had been in business for about 18 months. It was developing a product—I don't even understand exactly what it does—and they had not made a sale yet, nor had they planned to make any sale. And they were just starting to go out into the market. They would not even show their product to a potential customer unless the customer would sign a nondisclosure agreement as to what it was, because they did not want any competitors to get an advantage. They were confident that they were going to make it. In fact, they now have made it; they have been in the market about nine months, and they are doing extremely well.

That company would not have been formed had all capital been taxed equally. Those people would never have left the companies that they were with if all capital was taxed equally.

Mr. SAMUEL. Mr. Chairman, could I respond to that just momentarily? It seems to me that your position, particularly as chairman of this very important committee and in government as a whole, are you willing to make a decision that it is more important that that particular company was founded or was continued? Or that we have a viable steel industry such as National Steel, whose chairman was also a member of our commission, also continue to make steel and provide jobs in the steel industry? Or that the Government have the resources to build roads and bridges, and improve our educational and health systems and housing, and so forth?

The CHAIRMAN. I was going to get to that before we were done, because that is the fundamental question.

If you were to ask the president of United States Steel which is more critical, he would say the double taxation of dividends and the corporate profits level is more important to his company than capital gains and stock options, and it is the difference between utilities and old solid companies and new venture companies as to what it is that attracts them in.

It has been, unfortunately—or fortunately, as the case may be—the smaller companies, if you want to call 100-or-less small, that have provided almost all of the new employment in this country in the last 10 or 20 years, and it is the large companies that have had losses in employment, probably because they have been modernizing and roboticizing and getting more efficient.

But your question is perfectly valid, and I would put to you one more, and one might as well get to it now:

Assuming equal taxation of capital, and assuming a level playing field internationally, are we prepared to say, "Let the devil take the hindmost"? And if we cannot on a level playing field, with an equal access to capital, if we cannot compete with Brazil in steel, then we will have no steel industry? Are we prepared to say that as a country?

Mr. SAMUEL. I think not. The fact is that a country as large as ours, and in accordance with the role that we must play in the international arena, that we must have a large and diversified manufacturing sector.

The CHAIRMAN. Does the Industrial Union Department represent most of the employees that would be in the shipyards?

Mr. SAMUEL. Yes, we would. Yes.

The CHAIRMAN. But on a level playing field, can the United States shipbuilding compete in the international market?

Mr. SAMUEL. Well, of course when you are dealing with shipyards you are dealing with security protections.

The CHAIRMAN. Well, we are dealing with security as far as military ships, because we compel them to be built in America. We don't compel commercial ships to be built in America, and therefore we haven't built a major commercial ship in this country in the last 5 years.

Mr. SAMUEL. Right.

The CHAIRMAN. Can we compete internationally on a level playing field in shipbuilding?

Mr. SAMUEL. Mr. Chairman, I don't know enough about the shipbuilding industry to give a very profound answer on that. Nor can I say that in needing a very large and diversified economy, the manufacturing sector, that means that every single industry must survive. As you know, there are certain consumer electronic products we don't make, that we don't make 35 millimeter cameras and haven't made in a long time and seem to have survived for a long time without that.

But the fact is, in general terms, I think we must retain our major industry.

Let me just comment on one colloquy that you had before with John Young in regard to the textile industry. In the early 1960's, if we had had this colloquy, you probably wouldn't have asked me about shipyards, you would have asked me about textiles, because at that time we all agreed—probably even Fred Dent may have sorrowfully agreed—that the textile industry was on its way out. Largely because of the fact that we were able to provide a more level playing field, particularly starting in the early 1970's, the textile industry revived, and before we came into our present economic difficulties with the overvalued dollar the textile industry was providing us with $3 to $4 billion of trade benefits. It was an exporting industry. It was an industry which was a success story.

If we had made a decision back in the early 1970's that textiles could not survive, we would have lost not only employment but an important industry, and an exporting industry which I hope someday we will go back to being an exporting industry.

So, I think it is very dangerous for anyone to say, "This industry should not survive; this one should." The marketplace does have a major role, but there are limits. I think we have to have a steel industry; I think we have to have an automobile industry; I think we have to make apparel and textiles—major areas of our industrial sectors I think must be retained in a nation as large as ours.

Senator BRADLEY. Mr. Chairman, if I could, I would like to ask a series of questions just to get a yes or no, just to come back briefly to the previous exchange about capital gains and double taxation of dividends.

I think what both the steel industry and this young company that the chairman was talking about would agree on is that both of those desires for the retention of capital gains and for the elimination of double taxation of dividends would be less pressing for them if the top marginal rate was much lower. I think you would get both of them to support dropping the top marginal rate of the income tax system.

Yes or no answers. Are you for a new round of trade negotiations?

Mr. MAUER. Yes; I think it is badly needed.

Mr. HARDAGE. Yes.

Mr. DENT. Yes.

Mr. SAMUEL. With some very careful guidelines and ground rules, yes.

Senator BRADLEY. Do you believe that U.S. domestic economic policy as it is now conducted takes into consideration the international ramifications of that policy?

Mr. MAUER. No, not very well.

Senator BRADLEY. This is macroeconomic.

Mr. HARDAGE. No.

Mr. DENT. Not at all.

Senator BRADLEY. Thank you very much. I think that clearly that indicates one of the major shortcomings of our economic policy and our ability to try to make ourselves more competitive. We are formulating domestic economic policy that essentially shoots us in the foot when we go out to try to compete with our allies.

I think that your confirmation of that is significant. Thank you.

The CHAIRMAN. Senator Chafee?

Senator CHAFEE. Thank you, Mr. Chairman. I apologize for being late. As you know, Mr. Chairman, we are involved in leadership meetings on the budget.

First of all, I want to welcome my great old friend and classmate at Yale, Fred Dent, former Secretary of Commerce. Mr. Chairman, I am not sure if you are aware of the fact that the Class of 1944 at Yale has a lock on the Secretary of Commerce. [Laughter.]

Fred Dent, and Mac Baldrige were also in the Class of 1944 at Yale, a very excellent class. [Laughter.]

The CHAIRMAN. You said you were a part of it?

Senator CHAFEE. I was a part of it, a small part of it. [Laughter.]

It also included, if you wish to go into further names, John Lindsay, Jim Buckley, a former member of the U.S. Senate—anyway, an unusual class at Yale, the Class of 1944.

I have read the report. I was sorry I wasn't here to hear all of your testimony and the testimony of John Young.

You know, Mr. Chairman, last year in the conference we had a Commission on Industrial Competitiveness, and we took 12 issues, and 10 of them were enacted. Now, that doesn't mean there is not plenty more out there to do. For example, I suppose you have touched on the extension of the R&D tax credit, and I know in the report it also mentioned the Foreign Corrupt Practices Act. I hope we can do things on that.

Plus, I know that you talked about the deficit, which we are working on right now and hopefully can be constructive.

But I just think that you gentlemen, all of you, deserve a lot of praise for having served on this. Was Egils here? Was he to testify? He was your executive director.

Mr. MAUER. Egils Milbergs, right, sir.

Senator CHAFEE. Yes; I met with him earlier, because I have been most interested in this project, I will read over the testimony and look at the statements you have submitted.

I will just tell you, we are determined to do something about all of this. Certainly, this committee is, and I think the U.S. Senate and as Congress a whole is.

So, this is a report that isn't going to gather dust on some shelf. Plenty of reports around here do, but I think this will give us a guideline on what we should be working on because it's a distinguished commission that put this together. We are grateful to each of you. Thank you very much.

Mr. MAUER. Thank you.

Senator CHAFEE. Thanks, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Chafee.

I still have some more questions, if you fellows don't mind staying a bit.

Mr. Dent, did you hear the exchange that I read, between myself and Mr. Eisen?

Mr. DENT. Yes; I did.

The CHAIRMAN. Do you agree with him? In textiles, can you compete in the United States if you have a level playing field? And "level playing field" did not include wage equality. We assumed a tremendous disparity in wage difference. Can you in the textile industry compete in this country if you had what we would call a reasonably level playing field?

Mr. DENT. The U.S. textile industry, by international survey, is the most productive in the world. Just last week we were calculating that our employees in 4 hours earn what a Chinese earns in 1 month, so that there is a tremendous disparity.

The definition of "a level playing field" is very hard to achieve, but if we could achieve it, the industry is highly productive, dedicated to the highest quality in the world, and is extremely innovative. All of the products coming in are knockoffs of American fabrics, styles, except for Indian madras which bleeds, and probably the FDA wouldn't let it be sold if American companies made it. [Laughter.]

Everything else, basically, is a copy of American development.

The CHAIRMAN. Your answer, therefore is, given a level playing field you can compete, and you wouldn't need textile agreements or quotas or anything else?

Mr. DENT. That's correct.

The CHAIRMAN. Now, Mr. Eisen also said, as far as the apparel industry is concerned, "No." That even with a level playing field, we cannot compete. Do you agree with that?

Mr. DENT. Yes; for this reason: The textile industry has invested, in most of the plants, in the best technology that is found anywhere in the world, and has become extremely productive. There has not been the technological development in apparel manufacturing that there has been in textiles.

Unfortunately, MITT is putting about $50 million a year into developing an automated Japanese apparel manufacturing system. The U.S. has a much smaller project going on at Draper Labs in Massachusetts. But I think that, with the Japanese investment, they will probably be there sooner with a greater development.

The CHAIRMAN. Now, is this in apparel?

Mr. DENT. Yes, sir.

The CHAIRMAN. OK.

Mr. Samuel, can we compete in this country, given a level playing field, can we compete in our market in automobiles with all kinds of imports?

Mr. SAMUEL. I think, generally speaking, yes, we probably could.

The CHAIRMAN. So, is the reason we had a difficult time with the Japanese for a long period of time that it was an unequal playing field?

The reason I ask this is that I recall there never were any subsidy charges or countervailing duty charges involving the Japanese cars.

Mr. SAMUEL. No; I think the Japanese, the average Japanese manufacturer including the automobile industry, benefits from a number of government services that are not provided here. The government, as you know, intervenes in Japan, as it does in almost every other developed country in the world, to an extent that we wouldn't dream of having here. And this does benefit the individual manufacturer, to an extent we do not share.

The CHAIRMAN. They intervene, although ironically they have a lower total tax rate than we do. So, the intervention is not services that cost money.

Mr. SAMUEL. No; not necessarily. As we talked about before, the cost of capital in Japan is considerably less because of a different kind of a culture. If we were willing to all live in houses with roughly 1,000 square feet and were willing to live without a Social Security System, I think we would have a higher savings rate, so we could have capital from other than the market costs, and so forth.

The CHAIRMAN. In fairness, in comparing the Japanese tax rate—and this was called to my attention by one of the economists at the World Bank. He said you've got to be careful in comparing the Japanese tax rate, because they provide through business many of the social services that we provide here through government. And if you mean is it a cost to the business, it is. It just isn't counted as a tax. They just have a much more paternalistic economic industrial system vis-a-vis their employees than we do.

Mr. SAMUEL. I think that can be overstated, Mr. Chairman. In the apparel industry, if you go into the average shop making apparel, you will find that the workers—mostly women, and, of course, this is true here—that none are over the age of 25 or 26. They are paid by experience. The average Japanese woman goes into an apparel factory at age 15 or 16 at the very lowest level. By age 21 or 22, on the average, she is gone. She is assumed to have been married, but if she is or not, no one quite knows, but she's gone. You will find practically nobody beyond the middle twenties.

Are they still working? Yes; they are. They are working for very small contractors, and they are working at home. About two-thirds of the work is done at home.

The CHAIRMAN. But if you look at the relation of fringe benefit to wage in Japan versus America, their fringe benefit percentage is much higher than ours, providing a variety of benefits that we have not yet provided in this country. But that is neither here nor there.

I want to come back to the chairman's point. In the statement he made about international competitiveness, and assuming a level playing field, he would be willing to let the international economic competitive system sort out where businesses would exist.

Now, apart from national security, which we hopefully all agree on, would you be willing to do that?

Mr. SAMUEL. As I indicated before, I would only be willing to do that within limits. I said a country as large as ours cannot be subject entirely to the vagaries of the international competitive system. I don't think our country can survive without a reasonably adequate steel industry, auto industry, and basic metals generally, and so forth and so on.

The CHAIRMAN. Could we survive without an avocado industry?

Mr. SAMUEL. That's hard to say; my wife likes avocados, Mr. Chairman, and I'm not sure. I suspect we could. We probably could even survive without a clothespin industry, which was supported by ITC.

The CHAIRMAN. We have almost gotten to that place of surviving without it.

The only reason I ask this question is, I don't know if we are going to have to, in this Congress, come to decisions of that kind. Are there industries we have to have? Clearly, we are going to say steel—yes, we have to have it. Autos? Yes; we are going to say that. Textiles? My hunch is, we are going to say yes.

There are going to be some industries that are going to have perfectly legitimate claims—"We employ the unemployable and the low-wage workers, and they wouldn't work anywhere else if they didn't work for us, and we are not going to make it unless you support us." And you say, "Does this country have to have this industry?" And most rational people would say, "Well—we'll make it without them." I don't know if we are going to have to come to that or not in this Congress.

Mr. HARDAGE. Mr. Chairman?

The CHAIRMAN. Yes, sir?

Mr. HARDAGE. I, certainly, hope that you don't have to make that decision. You alluded to and we discussed earlier the fact that we have generated millions of jobs in this country and that our European competitors haven't.

One of the problems, of course, I think facing Europe now is that they made the decision many, many years ago to protect many industries, and they subsidize them with government payments. They are unable to compete without a drain on the public treasury, and they have locked themselves into that situation in addition to the situation of the inability to change very rapidly in employment.

Many countries, for example in Holland, the employees are basically locked in for at least 1 year.

The CHAIRMAN. You put your finger on it very well, because now not only have they not created jobs and have attempted to protect old industries, now their unemployment level in Europe is significantly higher than ours, and they haven't got any new jobs.

Mr. HARDAGE. That's correct.

The CHAIRMAN. I don't know what they do.

Mr. HARDAGE. I don't think they can predict where the new job generators are going to be for tomorrow, but that is for the geniuses of all of America, of our whole Nation, to decide and through the free market.

Mr. SAMUEL. It seems to me, Mr. Chairman, that you have a vehicle so that Congress should not have to take that burden. That vehicle is section 201 of the Trade Act. The problem is that section 201 is not very well implemented and is not very well drawn up. You know, the standards of 201 are tougher than they are in GATT.

The other failure in 201 is that, after we give relief to an industry, there is no obligation on the industry to do anything with that period of relief to make sure that it can survive.

So, one of the recommendations that I think Congress should well consider is whether 201 should not be linked to some opportunity for modernization of individual industries.

If, given a period of relief from surges of imports and given some opportunity to modernize, an industry cannot survive—assuming it is not as important as steel and auto and so forth—then, obviously, the marketplace is going to have to play a major role.

The CHAIRMAN. Mr. Mauer?

Mr. MAUER. Mr. Chairman, particularly in this auto area, we need to recognize there are different reasons why people have preferences for certain kinds of products. Style may be a very important interest to some people, quality can be a very important interest, efficiency of the machine itself may be of high interest, particularly during the last decade. There are many reasons other than initial cost as to people's interest, and therefore their preference in many kinds of product.

If we take a look at some of the steel industry, for example, we need to recognize that by allowing the status quo to pretty well manage the system, we also build in great inefficiencies, and by sheltering, ignoring, or not subjecting them to the vagaries and rapid changes in the marketplace, we also encouraged the great difficulty many are now in. A good study in capital shortage, management inefficiency, and status quo posturing.

The CHAIRMAN. A question, then: In reverse, why doesn't that happen to Japan? They are so highly protectionist, they don't allow any foreign competition to come in and compete with their domestic industries. Why don't they become tremendously inefficient?

Mr. MAUER. I believe we need to look at the history and culture that these people have evolved out of especially since World War II. That competitive and productive, and tenacious cultural environment of Japan, and maybe even the entire culture of Southeast Asia, is just now reaching out and up and setting their level of rising expectations. Their culture also lends itself to working very hard, being very dedicated to cause, and recognizing that high educational standards are also a very critical part of the cultural, competitive process.

So, you now see the cultural chemistry within these people, they tend to be very tenacious, very high skilled, very hard workers, and very willing to sacrifice short term for longer term kinds of objectives.

Mr. SAMUEL. But besides that, Mr. Chairman, also Japan has had to survive in the international marketplace since the beginning. We have not.

Senator CHAFEE. Mr. Samuel, I have a question here. It seems to me we are going to get into some difficulty if, in describing an "even playing field"—and I might have misinterpreted what you said—that we must take into account that we have Social Security and they don't.

It seems to me that all this Government of ours can do, at least all that I'm prepared to do, is to make certain that the restraints that are imposed on our exports to Japan are eliminated, that we do everything we can to eliminate the disincentives that are provided to our exporters in America, and make sure that those subsidies that we can really tabulate that are given to the foreign industries are made up with or countervailing duties of some type are imposed.

But it seems to me that—and I may be wrong in interpreting what you said—that if the definition of "an even playing field" requires that they have every law that we have, in OSHA or whatever it might be, then we are really in trouble. Could you expound a bit on your remarks that they are prepared to go without Social Security, for example?

Mr. SAMUEL. I probably was not clear, but I was only referring to one of the major reasons why their savings rate is so much higher, and as a result why their cost of capital is so much lower—that two of the costs that make it possible for us to not so necessarily have to save is the fact that we have a Social Security System. The Japanese have to save for their retirement; they have a very inadequate Social Security System. And second, because we spend a lot of our money for housing as the Japanese do not. And with the various tax benefits and conditions.

So, as a result of that, our savings rate has never really changed very much, in spite of all of the incentives that Congress has tried to pass to encourage it—because of the fact that we spend our money in other kinds of areas and the Japanese do not.

Senator CHAFEE. Well, as you know, we seem to be ambivalent as far as encouraging savings. On the one hand we enact an IRA or a Keogh, and on the other hand we permit the deductibility of interest. And hopefully the revisions we will make in the so-called tax reform will take care of that.

Let me ask you another question. In Mr. Young's statement—and I'm sure from your own experience you can probably validate this—he says in point 4, "Our productivity growth of the past two decades is outstripped by just about all of our major trading partners." That's pretty discouraging, particularly in light of the testimony that Mr. Dent just gave, that we are modernizing in our textile industry.

How do you account for that astonishing statement, that they are outstripping us in productivity? Anybody.

Mr. Hardage?

Mr. HARDAGE. Well, sir, Senator Chafee, I think that we could certainly point to the higher cost of capital in the United States. We are unable to employ enough capital to modernize our facilities, to invest in new plant and equipment.

I think that Mr. Dent can certainly speak to that issue. We were talking about it at breakfast earlier today.

If our cost of capital is twice that of Japan, then clearly, in order to be competitive in the same industry, we are going to either have to cut wage costs or buy materials from some other source. And since there is in essence a worldwide market in materials, the only other way we can do it is to cut labor. I don't think anybody wants to do that.

Certainly, we have made several recommendations this morning ~~that~~ would have a dramatic effect on lowering the cost of capital.

It is an issue which has not been addressed. I think that it is one where, certainly if we are going to correct the situation where our workers, for example, over the last 10 years in real terms, their wages have remained stagnant, our productivity is lessened. We are losing our competitive edge. And that was the thrust of the report.

So, I think that certainly the elimination of double taxation of corporate income, the elimination of capital gains taxes, would go a long way toward enabling us to increase our productivity, increase our savings rate, invest more in plant and equipment, give our workers in America the ability to compete with lower wage rate countries so that we can compete in the international and the domestic marketplace.

Senator CHAFEE. I'm sorry, I didn't realize that one of the recommendations in here is to eliminate the double taxation of dividends.

Mr. HARDAGE. That is correct, the elimination of double taxation of corporate income.

Senator CHAFEE. Well, how do you suggest to do that? Would you make any dividends deductible by the corporation?

Mr. HARDAGE. Well, there are many ways. We did not make a specific recommendation as to how. We made general recommendations as to the tax policy. But several companies have given a shareholder dividend credits. There are many different ways to do that.

You could simply eliminate the taxation of dividend income to the shareholders, so that the income was taxed once to the corporation and as it was passed out to the shareholders it would not be taxed again. Or you could not tax the corporate income and tax it when it was passed out as a dividend.

Senator CHAFEE. Does anybody know—one of your points, "remove the antitrust barriers to joint research." Last year we thought we had done that. As you know, through the Judiciary Committee and through the whole Congress we passed legislation to permit a joint R&D by various corporations. We thought we had done a pretty good job. But here, that is one of the recommendations.

I don't want to pin anybody down, but does anybody quite know why what we did last year wasn't adequate?

Mr. MAUER. I don't think it is a question of adequacy at this time. The Commission has had a life of some 18 months now, and this was an overlap between some of the work that was going on in the Congress and some of the work that was going on in the Commission. Obviously, we feel it is an issue, it was an issue, and even though it has been addressed by the Congress, it is a very key component of the process.

If I could also address the question you just asked, Senator. In addition to capital flowing to highest and best use in the private sector, we need to recognize that there are other critical components that go into our ability to be productive and competitive. Some of these components are more than plant and equipment and machinery and so on; other components are the international trade laws GATT and others, lowering barriers and particularly nontariff barriers that are often impediments to our ability to trade.

Human resources is an area that Howard Samuel and I have spent a good deal of time on, and this also means our educational arena, our technology, our engineering, our scientific endeavors, our innovation, and our creative environment. We addressed these and others at great length in our Commission deliberations

So what I am suggesting is, there is a great deal of activity that needs to come together for us to go from the 1.2 average productivity increase per year, over a decade or so, to much higher levels, to continue to compete in key world economic environments.

Mr. DENT. Senator, might I address your question on productivity?

One of the things that the Commission recommends is that we make industrial competitiveness a national priority. I believe that one of the reasons that we have lagged in productivity is that we have been complacent. During the late 1960's and 1970's we had a regulatory burden placed on business and industry in this country that is unmatched in our history.

We unfortunately have had a management which has not moved ahead technologically and innovatively as it should. We have had a general public who has permitted the education and training of engineers to lag. We produced about a quarter, proportionately, of what the Japanese do of engineers in any school year.

I think it has been a general problem, the burden of which belongs on governmental policy and attitude, industrial management, business management, and the general public. The country has been complacent. We have had competitors, particularly in the Far Eastern rim of the world, who have used U.S. productivity as a goal and objective. And in Western Europe, unfortunately, governments there undertook to subsidize many of the industries which they owned and felt responsibility for.

One of the great things, hopefully, that will come out of this Commission is to reawaken America to the fact that we are no longer out in front; we've got to buckle down, and with all of these elements get to work on increasing productivity and competitiveness.

Senator CHAFEE. Well, I won't argue a bit with that, and I think the clarion call has been sounded by this Commission. I hope the word does go out, and we are going to try to do our part.

As I mentioned, the concept—or I will say—the concept no one will argue with is good; it's when you get into the details that problems arise.

Let me just give you a tiny example that perhaps you can be of help. We in the Senate have passed a bill to revise the Foreign Corrupt Practices Act, not to permit bribery overseas and to define what is bribery and what isn't, what a company can do and what they can't do. That has passed the Senate, and it gets nowhere in the House of Representatives. Mr. Brock and others have worked extremely hard to do something about that, but we just don't get to first base. That is one of the things that you touch on in your report, and we will try again on that.

I think each of the issues, certainly from this committee and I believe in the Senate as a whole, you are going to see us do the best we can to be helpful.

Thank you, Mr. Chairman.

The CHAIRMAN. Gentlemen, thank you. It has been most helpful, and I appreciate it.

Mr. HARDAGE. Thank you, Mr. Chairman.

Mr. DENT. Thank you.

Mr. SAMUEL. Thank you.

Mr. MAUER. Thank you.

[Whereupon, at 1:48 p.m., the hearing was concluded.]

[By direction of the chairman the following communications were made a part of the hearing record:]

Cleveland

CLEVELAND WORLD TRADE ASSOCIATION

AN AFFILIATE OF THE GREATER CLEVELAND GROWTH ASSOCIATION

March 22, 1985

The Honorable Robert Packwood
U.S. Senate Committee
on Finance
Washington, D.C. 20510

Dear Senator Packwood:

Having studied the Report of President's Commission on Industrial Competitiveness, the CWTA Foreign Trade Policy Committee has approved the following recommendations at its November 19, 1984 meeting:

1) Creation of an Interagency Council to establish local interagency export coordinating and delivery systems.
2) Clarification through legislation of the meaning and application of the Foreign Corrupt Practices Act and elimination of the conflicting aspects of the two Antiboycott statutes by developing a statutory statement establishing a national policy of noncooperation by U.S. firms with foreign boycotts.
3) Ask the Office of Management and Budget to identify nonfinance-related limitations on Eximbank that should be removed.
4) The President should initiate a new U.S. export promotion campaign in 1985. The campaign should include increased recognition for U.S. exporters.
5) Creation of a semi-private, non profit U.S. export promotion organization that would be managed by business and be financed through public and private sources. The goal of the organization would be to devise new initiatives to support firms new to exporting.

We also urge that the United States Government do all in its power to assure reciprocal market access for U.S. products. Specifically, a concerted effort should be made to obtain elimination of non-tarriff barriers of, and to secure adherence to the Multilaterial Trade Negotiations codes by our trading partners.

Very truly yours,

Herbert Hubben

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Statement submitted by David J. Steinberg, President, U.S. Council for an Open World Economy, to the Senate Committee on Finance in a hearing on the findings of the President's Commission on Industrial Competitiveness. March 29, 1985

(The U.S. Council for an Open World Economy is a private, non-profit organization engaged in research and public education on the merits and problems of developing an open international economic system in the overall national interest. The Council does not act on behalf of any "special interest".)

The Commission on Industrial Competitiveness has made a voluminous, valuable evaluation of a wide range of factors materially affecting the competitiveness of the U.S. economy in a rapidly changing world. Our Council's brief statement on the Commission's report is limited to issues of government organization and strategy to which we have given particular attention, uniquely so, for many years.

Government Organization

We agree with the Commission's view that substantial restructuring is needed in the way the Executive Branch deals with trade policy. The Commission is rightly concerned that "trade and international economic policies ... (should have) equivalent stature with domestic economic, national security, and foreign relations policies." It is rightly concerned over the failure of government (because of the multiplicity of agencies with jurisdiction in trade matters and the inadequately crafted system of inter-agency coordination) "to focus on trade in all its dimensions" and to make decisions as quickly as situations demand. The Commission urges organizational changes calculated to make trade a permanent national priority, establish a mechanism to enunciate trade policy with a single strong voice, eliminate duplication and overlap, and "establish a more effective coordinating mechanism under the direction of the President." However, except for its advocacy of a Cabinet-level Department of Trade, its proposals on government reorganization are too vague, and the proposed creation of a Department of Trade is itself vulnerable to criticism.

In our view, a Department of Trade would not be able to consolidate all, even most, of today's departmental jurisdictions materially affecting trade policy into one agency. Nor, considering the Department's major concern with the problems and needs of U.S. industries (presuming that this responsibility would be transferred to the new agency from the current Department of Commerce), is such a department the proper place to invest with primary responsibility for planning and coordinating national trade-policy strategy -- if the strategy the nation needs (as our Council uniquely believes it does) is aimed at progressively freer trade, in fact at negotiation of a free-trade arrangement with as many countries as may be willing to join us in such an ambitious initiative.

The restructuring best calculated to elevate trade policy to the priority the Commission has in mind, and (see above) to establish an "effective coordinating mechanism under the direction of the President," would be creation of an inter-agency council on international economic policy chaired by the President and whose executive vice-chairman (subject to Senate confirmation) would also serve as chief trade negotiator. This council should be equivalent in stature to the National Security Council. Trade strategy, and its coordination with all pertinent policy areas, would be centered, not in one of the regular departments of government, but in the Executive Office of the President.

Domestic Adjustment

This is one of the more disappointing parts of the report. The Commission could and should have done more than recommend that the President establish a task force of government agencies and industry, labor and agriculture representatives to examine U.S. trade law remedies with a view toward developing recommendations for an omnibus trade bill that will facilitate industry adjustment to increased global competition and serve other purposes (not clearly defined). For example, the Commission should have recommended at least general outlines for converting escape-clause proceedings into instruments for coherent industry-adjustment strategies addressing the real problems of seriously injured industries and involving appropriate commitments by government, industry and labor. Import restriction should be ruled out except as a last-resort component of a coherent, industry-adjustment strategy.

The Commission should also have raised industrial, labor and overall economic adjustment to the same level of national priority it proposed for trade itself. The nation needs to launch a coherent redevelopment initiative to backstop a coherent, consistent, free-trade policy. The two are inseparable, just as totally fair trade and totally free trade are indivisible components of the trade strategy the nation needs -- an avant-garde proposition our Council has articulated in many places for many years. For this purpose, an inter-agency national development council (chaired by the President) should be formed, equivalent in stature to the foreign-economic-policy council I have recommended -- equivalent, in turn, to the National Security Council. The new priorities which such organizational changes would impart to trade and adjustment would be unmistakable.

<u>Trade Negotiations</u>

The Commission's recommendations concerning a new round of trade negotiations also fall short of what is needed. The next round, as envisaged by the Commission, would address "the key trade-distorting issues of the coming decade" -- including, most urgently, "government practices affecting industry, import safeguards, countertrade, commercial counterfeiting and intellectual property rights, direct foreign investment, performance requirements, international tax practices, trade in services, trade in agriculture, and the GATT dispute settlement process." Important as attention to these issues would be, the objectives of the proposed round are not sufficiently comprehensive; nor is it likely that much progress would be made even on this less ambitious, allegedly more realistic, list outside the framework of a dramatic effort to program completely free trade (coupled with completely fair trade) in accordance with a realistic timetable.

The Commission had an opportunity to raise the sights of the government and the American people to the free-trade initiative needed in foreign economic policy and the related full-employment, redevelopment strategy needed in domestic economic policy, and what needs to be done to make such ambitious efforts politically palatable. It missed the opportunity, as has every other Presidential commission that has addressed some aspect of America's position in the world economy.

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