Testimony
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"The Government as Dominant Shareholder: How Should Taxpayers' Ownership Rights be Exercised?"

Good morning, Mr. Chairman and Ranking Member Jordan and Members of the Subcommittee. On behalf of the 1,900 member companies of the U.S. Business and Industry Council, I am honored to testify at this hearing on managing the federal government's new shareholder rights under the Troubled Asset Relief Program to help spur economic recovery.

Given the continuing crisis afflicting the U.S. economy – which no major authorities believe can perform acceptably without continuing, indefinite, record government stimulus – few issues facing the nation today matter more. In this vein, our organization is especially grateful for your interest in our views. Our members predominantly are domestic manufacturers. They represent a wide range of industries, but they have always been united in their determination to generate wealth, innovation, and good jobs in this country – not China or Mexico or India. As such, they and companies like them are central to any successful recovery strategy pursued by our nation. For the only way to restore genuine health to our debt-addicted economy is for America to start producing more than it consumes, and manufacturing overwhelmingly dominates the economy's productive sector.

The flip side of this insight is true as well. If Washington continues its long-time neglect of the productive domestic activity embodied by domestic manufacturing, and continues abetting or ignoring the stagnation and now decline of industrial production and employment, our overspending and over-borrowing will need to continue in order to maintain U.S. living standards. Therefore the hole we have dug for ourselves will only deepen – that is, as long as the rest of the world, which supplies so much of our credit, keeps playing along. Our member companies – who make most of their money and create most of their jobs by supplying much larger manufacturing companies greatly infatuated with offshoring production and jobs – will be leading victims of continued status quo economic strategies. But ultimately, none of the U.S. economy will escape their ruinous consequences.

The federal government's new role in key sectors of the economy provides an opportunity that must not be missed to spark the fundamental course change needed for recovery. After all, the U.S. government is now a major shareholder in gigantic finance companies – including those that led the wave of crackpot innovation that contributed so significantly to the crisis. And it plays the same role in the remaining U.S.-owned share of the automobile industry – whose troubles epitomize how Washington has undermined domestic manufacturing, and continues to set the stage for failure.

As a result, the most important objective for the government's new shareholder role must be to spearhead the reorientation of America's economy from one based mainly on rearranging and leveraging wealth already created, to one based mainly on creating new wealth in the first place. Indeed, this aim must now organize all of the federal government's economic policies, including its procurement policies and its efforts to promote wholly new industries, like so-called green manufacturing.

Tragically, under both the Bush and Obama administrations, Washington's performance as shareholder has served mainly to buttress the U.S. economy's current, failed, finance-heavy structure.

I

The critical measure of America's progress in overcoming the current crisis is not the reinvigoration of Wall Street, the restoration of ostensibly normal, pre-crisis levels of credit-creation; the return of ostensibly normal, pre-crisis levels of consumer spending; or even the restoration of economic growth and job creation. As should be obvious by now, flooding the economy with supposedly free money can eventually accomplish most or even all of these goals. But unless everything learned to date in human history is completely wrong, none of these accomplishments will be sustainable.

Genuine recovery will have begun when the productive sector of the U.S. economy – and the manufacturing sector that dominates it – starts growing fast enough to enable significant repayment of America's debts without requiring a significant fall in the country's living standards. Achieving this goal means that domestic manufacturing must grow significantly faster than the rest of the economy, and reverse the trend of recent decades in which it has fallen as a share of gross domestic product. The more relative manufacturing growth can be generated, the less living standards will need to fall to permit the repair of our national finances.

My testimony will focus on growth – i.e., production – rather than on jobs for two main reasons. First, the employment situation in general, and in manufacturing in particular, is already well known. No member of this subcommittee needs further briefing on that score. Second, and more important, although creating many more high-paying manufacturing jobs for working families is essential for real recovery, the vital prerequisite for job creation is restoring the health domestic manufacturing industries and boosting their output. Without healthy, expanding industries, manufacturing job growth will never occur.

Yet the economy is moving in exactly the opposite direction. In 2008, for example, the economy overall contracted by 0.74 percent after accounting for inflation. The manufacturing sector, however, shrank by 2.74 percent. Manufacturing's contraction was not as fast as that of construction of finance. But those sectors of the economy were clearly bubble-ized to a ludicrous extent. Some of the economy-wide bubble-ization undoubtedly spilled over to manufacturing, but the benefits undoubtedly were minor.

These kinds of authoritative government figures are not available yet for 2009. But the best government data we do have shows no significant improvement. The Commerce Department's Bureau of Economic Analysis tells us that real GDP has shrunk by 1.15 percent so far this year (through the third quarter). We will not get comparable figures for manufacturing until mid-2010 – an issue to which I will return. But we do have the Federal Reserve's Index of Industrial Production. It shows that manufacturing has expanded in real terms through September of this year – but only by 0.43 percent.

The same data sources show that, since the recession's official beginning in December, 2007, manufacturing output has plummeted 13.68 percent in real terms. The rest of the economy has shrunk by 2.99 percent. In other words, the U.S. economy must start closing the longstanding performance gap between the wealth-creating sectors of the economy and the rest of the economy. Yet the gap keeps widening.

Another gauge of manufacturing's health that I've recently examined tells a similar story. The nosedive in manufacturing capacity utilization this year to historic (post-1948) lows has been closely followed. (We are now just over 2.5 percentage points above that historic low of 65.12 percent.) Much less noted have been the trends in manufacturing capacity itself – the wherewithal of America's domestic industrial base. During this recession, industrial capacity has fallen in absolute terms for only the second time since figures have been compiled (also 1948). The first time, incidentally, was not during the relatively painful recession of the mid-1970s nor during the relatively painful recession of the early 1980s. It took place right after the relatively mild downturn of 2001. But during this recession, capacity has diminished by more than three times as fast (by 1.05 percent vs. 0.29 percent) even though the current period of decline so far has been only half as long.

To be sure, this shrinkage no doubt in part reflects efficiency gains. But domestic manufacturers didn't start to become efficient in 2002 or in 2008. Therefore, it is reasonable to conclude that this capacity decline is another sign of structural weakness in domestic manufacturing.

II

So far, it has been difficult to find examples of the federal government using its shareholder role in private industry to encourage our country's urgently needed economic rebalancing. One obvious indicator is the whopping imbalance between resources devoted to the financial sector and resources devoted to the manufacturing sector. In fact, this imbalance permeates the Obama administration's recovery policy – and Congress' support for it.

Yet a neglectful attitude toward manufacturing is evident even in the government's specific shareholding activity. For example, this past summer, combined pressure from the United Auto Workers and some members of Congress appears to have forced General Motors to scrap its plans to increase significantly the number of vehicles it imports through 2014. Also last spring, Congress in the American Recovery and Reinvestment Act banned banks receiving TARP money from hiring immigrants who hold H-1B visas.

Yet note the source of these measures – not the Obama administration, but organized labor and Congress. Apparently it never occurred to the White House that the main purposes – indeed the only legitimate purposes – of rescuing GM and Chrysler from uncontrolled bankruptcy was to ensure the maximum possible amount of domestic automotive production and employment over a significant period of time. Certainly, the GM executives planning the import operation never got this message from the auto rescue task force, or from any other part of the administration. Indeed, there are still no signs that this message is being taken to heart; in October, former GM Chairman Fritz Henderson spoke publically of his plans to start sourcing more parts from Korea.

In fact, it is impossible to examine the auto rescue saga and find any thread of a coherent economic rationale – other than (a) hastily slapping a huge band-aid on a rapidly bleeding part of the economy (including, of course, the entire domestic automotive supply chain) at a time of particular peril, but then forgetting about how to encourage a genuine cure; or (b) assuming that GM and the new Fiat-owned Chrysler could remain competitive automotive producers as considerably downsized entities.

Clearly, maximizing domestic vehicle and parts production over time was not a priority – as we know from the official indifference not only to the ramped up importing, but to the extensive offshoring that has long been a mainstay of Detroit automakers' business models. Maximizing domestic automotive employment wasn't especially important, either, as is clear both from the indifference to offshoring and importing, and from the job cutbacks insisted by the administration as a condition of providing rescue funds. And the administration seems to lack any appreciation of the main value of automotive jobs – namely, the middle class lifestyles they have enabled huge numbers of working class Americans to lead. For the auto task force actively encouraged deep cuts in automotive wages and benefits. Meanwhile, the Fiat takeover of Chrysler – which had been German-owned for most of the last decade – shows that maintaining or promoting U.S. ownership has had no importance for the administration, either.

The band-aid rationale is understandable (if not remotely sufficient). But the administration's belief in the viability of what can only be called a mini-GM looks preposterous. For the last 20 years, vehicle and parts makers all over the world have been determinedly consolidating and seeking the greatest possible scale. Grow dramatically or die has been the mantra. Has this imperative suddenly vanished? Can GM really survive on its own as what looks like a niche producer – even though its niche won't exactly be in the Ferrari league?

Or is GM supposed to reach gargantuan proportions again once normality returns to the U.S. and world economies? If so, hope will have triumphed, not experience. For in normal times, GM (along with Chrysler and Ford, for that matter) were steadily losing share of the all-important U.S. market. Even assuming the company significantly raises its game over time, is the Obama administration also counting on its foreign competitors lowering theirs? Is the White House expecting new foreign markets, like China, to be the keys to GM's future? This expectation would inspire more confidence if GM were actually making serious money in China. It is not.

Alternatively, will the Detroit giant benefit from the Obama administration's planned export drive? Unfortunately, nothing known about foreign automotive markets indicates any interest in buying more products Made in America.

From the standpoint of the U.S. economy's health, the Obama administration's automotive strategy seems likeliest to leave the U.S.-owned vehicle industry in a position with striking similarities to its pre-bailout plight. GM will be able to play defense only – attempting to keep and then expand in its home U.S. market, but lacking any meaningful export prospects – versus foreign-owned rivals that can sell easily in their home markets and export freely to the United States.

The big change insisted on by the auto task force has been requiring GM to slash its labor costs and domestic production base. Talk about the low road to competitiveness. Why not simply force GM and Chrysler to pay Chinese-level wages and benefits? For good measure, the companies' regulatory burdens can be cut to Chinese levels, too. Their sales and exports would really take off then.

In sharp contrast to the administration's strategy of managed shrinkage for the U.S.-owned vehicle industry is its apparent game plan for finance. President Obama's hope for this sector of the economy evidently is for full recovery to its pre-crisis scale. Regulatory reforms are certain, to be sure. But nothing backed by the administration, or by significant numbers of legislators, seems to aim for or even envisage a significant reduction in either the volume of lending or the destination of lending. In fact, today's recovering financial sector is being slammed for not lending enough in toto, and not lending enough to classes of borrowers (homeowners and consumers in particular), who clearly have not been great credit risks.

American leaders in both parties seem to acknowledge that lenders' capital reserve requirements must be higher – at least in that portion of the financial world they are willing to regulate seriously. But they also want to leave a vast share of that world, and even the regulated portion, free to continue innovating, even though the economic record shows a tenuous relationship at best between recent financial innovations and healthy economic growth. After all, the main beneficiary of innovation in the financial sector was the financial sector itself. The rest of the economy grew unspectacularly during the early part of this decade – when financial innovation peaked – despite hitherto unprecedented government stimulus in the form of then-record low interest rates, and an equally dramatic swing in the federal budget balance from surplus to deficit.

Perhaps most important, neither the administration nor majorities in Congress seem interested in breaking up financial institutions that have been "too big to fail," or to prevent such behemoths from emerging in the future. As a result, whatever the final fate of the current TARP, it is difficult to believe that Wall Street risk-takers will worry that they have lost implicit government guarantees, and just as difficult to conclude that they are wrong.

Consistent with this indulgent position toward finance, the Bush and Obama administrations have showered literally trillions of dollars on the sector with virtually no conditions at all. This support, it must be remembered, stretches far beyond the TARP. It includes, for example, the

various measures by the Federal Reserve that have enabled financiers to borrow money at literally zero percent – a cost situation unknown in other industries and highly conducive to profitability. It also includes the decision to pay off government-owned AIG's counterparties at 100 cents on the dollar – a decision that puts, say, Goldman Sachs' repayment of its TARP loans in a strikingly new, much less impressive, light.
The bottom line: More than a year after Washington dramatically expanded its influence over and acquired a significant stake in the American financial sector, this sector remains full of institutions whose failure could generate systemic risk, but that arguably enjoy a stronger, more obvious government guarantee than ever. It is hard to imagine a better formula for continued, massive, open-ended taxpayer support of the sector – even as it stays or becomes superficially prosperous enough to lobby effectively against fundamental change. As a result, it is hard to imagine an outcome less likely to produce the political will or the resources needed to spur the production-oriented economic recovery America needs, or to create a production-focused economy.

III

As suggested above, the policy debate over government's role as business shareholder has been far too narrow. The overriding objective should not be re-privatizing as soon as the emergency is thought to have passed, or even recouping the taxpayers' investment, as desirable as these goals appear or actually are. The overriding objective should be transforming enterprises owned by the government and industries it now dominates, either through ownership or aid, from sources of weakness and vulnerability in the economy to sources of enduring strength. More specifically, this goal requires the government's policies for these sectors to focus on significantly increasing the share of the U.S. economy represented by its genuinely productive, wealth-creating sectors – first and foremost, manufacturing.

Moreover, because this objective is economy-wide, its implementation must be economy-wide. Its reach must extend across the range and breadth of national economic policy. The entire effort to re-regulate and restructure the financial sector must be included. So must all federal procurement, "Cash for Clunkers"-like tax subsidy programs, and efforts to create new industries such as green manufacturing. And so must all dimensions of national economic policy, including tax policy, regulatory policy in every respect (e.g., environmental, occupational and product safety), education policy, immigration policy, labor policy, innovation policy, health care policy, and trade policy. Confining this massive rebalancing effort to explicit stimulus programs or bailout programs would not only ensure its failure, but prolong and possibly deepen the crisis itself.

The U.S. Business and Industry Council considers fundamental change in trade policy to be especially important for two main reasons. First, manufacturing trade dominates the nation's international trade flows, and is therefore central to any strategy for paying down the nation's debts. Second, in a world of thoroughly globalized economic activity, better managing America's relationship with this global economy is essential for ensuring that the benefits of stimulus programs mainly stay within America's borders, and for preventing investors and companies from exploiting cross-border labor, regulatory, and policy arbitrage opportunities.

Aligning policy behind the goal of such re-industrialization will of course require an unprecedented degree of policy coordination. For example, it makes little sense to restore consumer credit to pre-crisis levels if consumers have little choice but to spend most of their consumption dollars on imported goods and services – as is so often the case. Adjustments in incentives for domestic investment as well as in trade policy will undoubtedly be required to change this situation as quickly and as extensively as possible. It makes little sense to pour government funds into education improvements if the best students still face overwhelming temptations to prepare themselves for careers as hedge fund managers, rather than scientists or engineers or industrial executives. It makes little sense to put into place a cap-and-trade system for reducing greenhouse gas emissions if manufacturers remain free to supply the U.S. market from foreign production sites with no or few emissions limits.

Many schemes for improving policy coordination have been developed – both since the onset of the current crisis and since Americans first began worrying decades ago about faltering economic competitiveness. Many of these ideas have considerable merit. Rather than pick and choose among them, I would emphasize three requirements that will make or break any of them.

First, even the most cleverly devised bureaucratic organizational plan will fail without the political will to launch it and keep it firmly on track, and without filling key positions with creative, resourceful leaders and managers.

Second, as much attention needs to be paid to monitoring and enforcing the implementation of new rules and regulations as to formulating them. Monitoring and enforcement are of course relatively un-glamorous activities, but unless Washington does a much better job on these fronts, lasting progress will be elusive at best.

Third, even the best thought-out strategies will fall far short of the mark unless the federal government and the American people have far more information about the economy and about individual industries at their disposal in a much timelier manner.

Data collection and dissemination are possibly even less glamorous than regulation monitoring and enforcement, but no less vital. There is no doubt that the federal government, along with many state and local governments, has done an excellent job in posting economic data on-line. But further improvement is possible and necessary. For example, I previously mentioned that detailed sector-by-sector figures on economic growth come out six months late. Lengthy delay characterizes other key sets of data as well. The monthly trade statistics are released two months after the fact. Detailed industry-by-industry manufacturing output data are two years behind the times. Total factor productivity numbers and foreign direct investment figures suffer a similar lag.

These delays result not from incompetence in the data gathering and dissemination agencies. Far from it. They result predominantly from grossly inadequate funding for these agencies. No new federal expenditure would yield bigger dollar-for-dollar benefits than greatly increased appropriations for their operations.

Better funded statistics agencies would also be able to provide new sets of data that policymakers and the public urgently need – especially to boost the economy's productive sectors. For example, the American Recovery and Reinvestment Act contain significant Buy American provisions. These provisions contain considerable potential to increase demand for U.S.-made goods. But these provisions were enacted before Congress or the administration or the American people had any idea of what kinds of manufactures could be readily supplied by domestic producers, and in which industries adequate domestic production capacity simply doesn't exist. Therefore, it is impossible to determine how much domestic growth these Buy American provisions actually will promote.

Just as important, this information vacuum is preventing Washington from using the Buy American provisions to identify promising opportunities for recreating critical domestic industrial capabilities. Policymakers so far have acted content to leave vast gaps in the nation's production profile completely unfilled – a position that is disturbingly fatalistic and even defeatist.

Thanks to legislation requiring domestic content stickers for all autos and light trucks sold in the United States, it is possible to determine how much domestic growth was actually generated by the Cash for Clunkers program. But no such figures exist for appliances and home furnishings, even though a Clunkers-like program now exists for the former, and has been proposed for the latter. As a result, both programs have the federal government flying blind. Further, the Obama administration clearly intends to spend billions of dollars fostering the development of green industries. But does it possess the means to identify which green products are likeliest to be made at home and which abroad? Or what the domestic and foreign content levels of these products will be, wherever they are finally assembled? Absolutely not – which means that, like Clunkers, these expenditures and tax credits could easily wind up stimulating more growth and employment overseas than in the United States, increasing America's trade deficits and overall indebtedness in the process.

Some flaws in the federal government's economic statistics, however, stem not from inadequate resources, but from flawed methodologies that have proven stubbornly resistant to change. For example, politicians and commentators typically seize on the headline labor productivity figures released every month – with virtually no delay – as evidence of the U.S. economy's matchless strength and potential. Yet more than five years ago, the officials at the Bureau of Labor Statistics who compile these figures acknowledged under oath to legislators that these labor productivity figures could well be sending an entirely different and much less encouraging message.

At a series of early 2004 hearings on the subject organized by Rep. Donald Manzullo of Ill. before the Small Business Committee he then chaired, BLS officials admitted that labor productivity improvements could in part reflect increased production and job offshoring, not technological or managerial progress. The reason: The foreign labor content of U.S. goods – surely on the upswing by then – was not counted. All reductions in the U.S. labor content of these goods, whatever their cause, were automatically attributed to innovation. Incidentally, similar problems plague the more comprehensive total factor productivity numbers. The Obama administration has acknowledged the problem, too, and fixing it should be a high priority.

IV

This testimony contains some important criticisms of the government's record to date as a shareholder, and sketches out a very ambitious agenda for change. It is nothing less than a call for sweeping change in the fundamental strategy pursued by the U.S. government to deal with the economy. The political and turf obstacles will of course be formidable. So will the ideological obstacles and the more practical obstacles surrounding implementation. Even with the strongest will and best talent, putting this program into effect will be exceedingly difficult. But the nation's present and foreseeable circumstances demand no less. That is why we call them a crisis.