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American Institute of Certified Public Accountants

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BAUCUS

SPEECH BY SENATOR MAX BAUCUS
AMERICAN INSTITUTE OF CERTIFIED PUBLIC
ACCOUNTANTS
May 24, 1988

Introduction

Thanks, Herb (Lerner).

I want to congratulate all of you for the victory on fiscal years.

We had a good amendment, and we stuck with it. I remember how Herb, Don, Ted and Mary Frances maintained the watch.

Long after others had given up, your team was still there plugging away. Helping me keep the heat on. Together, we didn't blink.

And as is too often the case in this town, a good idea is not always enough. You need persistence to make the wheels of government turn. Thanks to your persistence, we won an important battle.

Today, I'd like to talk about another battle that you and I and all Americans must join.

It is a battle for the economic future of our country.

On the surface, the American economy remains strong. Unemployment is down and the first quarter GNP figures were stronger than anyone expected.

Because of this, the next President--whether it's Vice President Bush or Governor Dukakis--will be tempted to muddle through, avoiding tough choices.

That would be a grave mistake. Below the surface, all is not well. America's long-term ability to compete in a global environment is steadily eroding.

Professor Paul Kennedy of Harvard, in a new book, The Rise and Decline of World Powers, describes our situation aptly.

After World War II, he says, America dominated the world marketplace. The expanding world economy generated more demand for U.S. products. And this generated a steadily rising standard of living.

Now, the post-War era has pretty much played itself out. American growth has flattened and other countries are catching up.

We can see it all around us.

We face fierce competition at every turn. From Europe. From Japan. From Brazil. And from the newly industrialized countries of the Pacific Rim.

Our share of world GNP has declined from almost 40 percent to less than 30 percent. We import almost half of our consumer electronics and one-third of our cars.

And look at the cutting-edge technologies. Half of our patents now go to foreigners. The Japanese are ahead of us on high-resolution TVs and giving us a run for our money in supercomputers. Robotics. Biogenetics. Ceramics and other materials.

And service industries. A few years ago, most of us hadn't even heard of the Tokyo Stock Exchange. Now, the Nikei Index is quoted every evening, right along with the Dow Jones Average.

Simply put, the world no longer revolves around Wall Street and Washington.

Our economic future is also being determined by decisions in Tokyo, London, Ottawa, and Bonn. And, increasingly, in Brasilia, Taipei, Seoul, and Mexico City.

You can even feel the change.

I've been to Japan 5 times. The first time was 1963. Japan was a developing nation, just getting back on its feet. Each time I've gone back, I've sensed greater self-confidence. Now it's almost smugness, mixed with concern about whether American can retain her greatness.

There's a lot more at stake here than our national pride.

In the long run, our standard of living, and our children's standard of living, depends on our ability to compete in the international marketplace. There's no other formula.

And the competitive decline is already taking its toll. For the first time in memory, our children no longer assume they'll be better off than their parents.

Average wages are lower, in real terms, than they were in 1972. Most mothers are now working, trying to make ends meet. It's harder than ever for young families to buy a house, save for their children's college education, and plan for the future.

If present trends continue, we'll be in the unpleasant position of fighting over a shrinking economic pie.

Harder, Smarter, and Together

The question, of course, is whether present trends will continue.

Some people have criticized competitiveness as a pessimistic idea. They say that we are Cassandras, who predict America's inevitable decline.

Well, it's only inevitable if we don't do something about it. On the other hand, if we acknowledge the problem and adapt, present trends won't continue. Our economic future will be brighter than ever.

Let's face it. For a long time, we were so far ahead of the competition that we could afford a little slack.

We didn't have to save as much as people in other countries. Or spend as much on R&D. Or pay as much attention to quality control. Or research foreign markets. Or develop close cooperation between workers and managers.

Now those bad habits are catching up with us. If American semiconductors have too many defects, the Japanese or French are ready to move in and take the account. If our cars are too expensive or undependable, the Japanese, Germans, and Koreans are ready to target the U.S. market.

We simply can't afford that slack anymore.

We have to start working harder, smarter, and together.

It may sound corny. But that's what this competitiveness debate is all about. We have to pay more attention to quality. To innovation. To long-term planning. To creating a sense of common purpose on the factory floor. To keeping up with what our overseas competitors are doing.

We have to stop exporting plants and start exporting products.

Competitiveness Policies: Reducing the Deficit

That's not only true for American managers. It's just as true of American public servants. When it comes to economic policy, we don't have that slack anymore.

We can't afford partisan bickering while our economic foundation is crumbling. And we can't afford to debate economic policy in splendid isolation, without considering the international consequences.

Nowadays, when we debate economic policy, competitiveness should be the first thing we think about, not the last.

The clearest example of this is the budget.

The national debt has doubled in seven years, to almost 2.5 trillion dollars. We've become the largest debtor nation in world history.

This has a subtle but terrible cost. The budget bleeds the country of capital that should be building new plants and new equipment. Every dollar of that deficit makes our next generation of workers less productive ten or twenty years from now.

Granted, we've made <u>marginal</u> progress reducing the deficit the past few years. But we still haven't buckled down and developed a comprehensive package that finally gets the deficit under control.

For several years, I've proposed a freeze on all federal spending. That would go a long way. We also must address the growth of entitlement spending.

But any serious deficit reduction package must also address revenue. It's simple arithmetic. A freeze on federal spending is a pretty tall order. So is limiting the growth of entitlements like Social Security. But even that would leave us with a deficit of more than $100 billion.

So we have to put taxes on the table. That's right. The "T" word. The word that the pollsters <u>tell</u> us to avoid.

So far, most of the debate has been about whether or not we need a tax increase. Another question is equally important.

That is, what <u>kind</u> of tax increase should we have. From a competitiveness perspective, all taxes are not created equal. Some would increase the cost of capital or make it harder for U.S. business to sell their goods and services overseas. That would be counterproductive.

On the other hand, some tax increases might <u>enhance</u> competitiveness. One example may be a consumption tax.

Whether it's a national sales tax, a gas tax, or excise taxes on cigarettes and alcohol, a consumption tax is preferable to an income tax if our objective is improved competitiveness. Another example might be a stock transfer tax that discourages "churning" in our financial markets.

I believe we have to look at all the options, debate them, and then decide. There are hard choices ahead, and the sooner we roll up our sleeves and get to work, the better.

<u>Competitiveness Policies: Capital Formation Incentives</u>

However, while we need to chart an overall direction for deficit reduction, we must also look at individual incentives to promote competitiveness. Including tax incentives.

Don't get me wrong. I voted for the Tax Reform Act. It accomplished some very important objectives.

But in our race to the finish-line we may have lost sight of the horizon. Congress was so determined to keep the package revenue-neutral, that we abandoned some worthwhile savings and investment incentives.

If we're going to be serious about competitiveness, we have reopen this issue. To help accomplish this, I will hold Taxation Subcommittee hearings, this summer, on specific proposals to encourage savings, investment, and workplace productivity.

Savings incentives may be the most important of all. The savings rate determines the cost of capital. And, as Peter Drucker noted in an article last year, raw materials and wages are becoming a smaller percentage of overall product costs. That makes the cost of capital an increasingly important competitive factor.

That's bad news, because we're way behind.

From 1960 to 1980, the national savings rate averaged 7.4 percent of GNP. Over the past five years, it has averaged 2.3 percent. In 1986, it was less than 2 percent of GNP. You heard me right; I said less than 2 percent.

That is less than half the rate of England, less than a third that of Germany, and about 10 percent of the rate in Japan.

Half of the decline in the U.S. rate is attributable to the rising federal deficits. The other half is attributable to the decline in the personal savings rate.

As you may recall, in 1981 Congress created tax incentives to encourage private savings. However, these proposals were flattened by that legislative and political steam roller called tax reform.

As Congress and the President broadened the base and lowered the rate in the interest of equity, savings incentives were eliminated or cut back to make the package revenue-neutral. And this was done without any consideration of the effect on our competitiveness.

That's important. Recent work by Larry Summers of Harvard indicates that criticisms of the effectiveness of IRAs may have been premature. In fact, according to Summers, there is significant evidence that, in fact, IRAs have encouraged new savings.

I agree with Professor Summers. IRAs and other savings incentives are on my agenda for hearings this summer. And because competitiveness depends in large part on the quality of the workforce, I will sponsor legislation to allow IRAs to be used for education and training.

Competitiveness Policies: Workplace Productivity

But competitiveness is more than the cost of capital.

It's also people!

Here's something to think about. Treasury's Office of Depreciation Analysis is working on a system for depreciating equipment that becomes technologically obsolete before it physically wears out. That's sensible.

But what about human capital?

The same technological advances that make equipment obsolete also make employee skills obsolete. What are we doing about that? How many firms have begun to think about that problem?

When it comes to basic education, we seem to be awarding diplomas for attendance rather than accomplishment.

Twenty-percent of American 18 year olds are functionally illiterate and 25 percent of our high school students drop out before graduating. Japan has the highest rate of high school completion and literacy in the world, over 90 percent.

This trend must be reversed, and I hope our next President will take the lead and not only say no to drugs, but say yes education.

We need greater support of advanced education. And we need to encourage continuing education--or retraining--so that U.S. workers are prepared for jobs that change with technological advances.

Some of this can be done through tax incentives. The Finance Committee has already held one hearing on incentives for education, and I plan to follow-up on this during the summer hearings.

In addition, we should consider other aspects of workplace productivity. One is research and development. Keeping American high-tech at the cutting edge.

The R&D Credit and the Section 861 allocation rules are effective incentives. But we can't seem to muster the political will to make them permanent. Like the battle for fiscal years, this is one fight I don't intend to lose.

And we can't stop there. It's becoming increasingly evident that the <u>key</u> is not just abstract research, but <u>commercializing</u> that research rapidly into products. Getting ahead of the growth curve.

Our current incentives do not apply to process technology or, to any significant extent, to commercialization. That must be our next step. We invented the VCR. The Japanese build them. That mistake musn't be repeated.

<u>Conclusion</u>

Now, it's been said that if you invite Max Baucus to address your group, he'll find some way to talk about competitiveness. I guess that's true. But there's a reason for it.

Every generation of Americans faces a challenge that defines its place in history. And I'm <u>convinced</u> that this generation will be measured by our response to the competitiveness challenge. We have our work cut out for us. We're not going to solve the problem overnight.

Tom Peters calls the solution "radical incrementalism." The fast-paced pursuit of small improvements. Every day. At every level. Here in Washington. And back home in your communities. In the boardroom and on the shop floor. And each of us has a part to play.

You are leaders of your profession and leaders of your communities. You advise our major corporations and our small business entrepreneurs.

Your knowledge and expertise can help enlighten the debate -- and help uncover new opportunities. I look forward to working with you in the years to come.

Thank you.