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Country and Company: Part II - Aligning Goals

The first part of this series asserted that what is good for the modern American corporation is diverging from what is good for our country. This second part describes ways to deal with that problem.

Right now all we want from our companies is to get people back to work and restore normal conditions as soon as possible. There is little thought and less agreement about what comes after that. But do we want to simply restore, unchanged, a system in which unbalanced international trade has severely damaged productive parts of our economy while the benefits of economic growth have gone primarily to a few?

It is much easier to see what we *don't* want, like huge Wall Street bonuses to reward massive failure, than it is to agree about what we *do* want. But if we don't know where we are going we are unlikely to get there.

In the first part of this series I wrote about two absolutely fundamental things that a country could reasonably want from its companies and called them "The Ketchum Goals."

(1) We want companies that are productive, each contributing as much as possible to the total of goods and services produced in the United States. It is the sum of these efforts that make America a prosperous nation.

(2) We want these companies to provide productive and well-paying jobs so that the value the companies create is widely shared by Americans. It is this widely shared wealth that gives the nation and its people economic security and stability.

Part 1 asserted that the present corporate emphasis on maximizing profit at all cost was not going to achieve these goals. In fact the overemphasis on profit was the main driving force behind the off-shoring of productive jobs and the unchecked thirst for huge rewards that brought down Wall Street and shook the economies of much of the world. Today even the former General Electric CEO who championed shareholder value, Jack Welch, has doubts about this direction.

How can we move toward these goals instead of away from them? We must take two absolutely fundamental steps to move toward the Ketchum Goals.

(1) We must have balanced trade. Without balanced trade productive companies operating in the United States are open to continuing assault from foreign entities advantaged by their governments.

(2) We must encourage and reward the productive companies that do provide productive jobs in the United States.

Step 1: Balancing Trade -- Theory versus Reality

When we have balanced trade the jobs that are lost because we import goods instead of making them in the United States are offset by the jobs that are created making goods for foreign markets.

If trade is unbalanced, as it has been for many years, goods keep coming in, but we don't balance them by making goods and services for export. Instead we sell our trading partners Treasury Bonds, which are essentially promises to pay later, or less often, ownership of some piece of the U.S. economy. Neither case leads to the creation of jobs in the United States. The first case adds to our already huge foreign debt, the second means that we are gradually turning over pieces of the country to our trading partners.

In free trade theory this unbalanced situation is supposed to be self-correcting. If a greater value of goods flow into the United States than flow out, currency exchange rates should automatically adjust to make imported goods more expensive and automatically rebalance trade. But suppose China, for example, engaged in building its economy by producing for export, subsidizes its industries so they become cheap exporters, and follows this up by preventing the rebalancing of its currencies.

The imbalance then continues. Companies in the United States are unable to compete at these artificial exchange rates and are destroyed, imports remain permanently larger than exports, and the jobs that would have made the goods to balance trade never materialize. *This outcome is inconsistent with both the Ketchum goals.* Balanced trade is therefore necessary if we are to retain productive jobs at home.

Testimonials to the importance of balanced trade are not lacking: Ben Bernanke noted earlier this year: "In my view, however, it is impossible to understand this crisis without reference to the global imbalances in trade and capital flows that began in the latter half of the 1990s." While G.E.'s CEO Jeffrey Immelt asserts: "If the U.S. government wants to fix the trade deficit, it's got to be pushed. GE wants to be an exporter. We want to be a good citizen. Do we want to make a lot of money? Sure we do. But I think at the end of the day we've got to have a tax system or a set of incentives that promote what the government wants to do."

There are many approaches to balancing trade. The most common proposals usually talk about our government "pressuring" Asian countries to change their currency exchange rates. This approach has produced little and it is hard to imagine why these countries should change a pattern that has worked so well for them just because it is harmful to us.

Warren Buffet describes in *Fortune* magazine the need for balanced trade and suggested an approach to obtaining it. Under the Buffet plan, exporters would receive certificates equal to the dollar value of the goods they export. Importers would need to buy these certificates to cover the dollar value of the goods they import. The certificates would be sold on an open market. This would force the value of imports to match the value of exports and, in contrast to quotas or tariffs, would not be aimed at particular countries or industries. This plan and some of its variants have been carefully studied (see forthcoming reports from the Economic Policy Institute) and it is now time to take this approach seriously.

Anything along these lines will be denounced as protectionism, which perhaps it is. But under any name it is much needed protection against destructive non-free-trade practices of other countries. The argument against protectionism always compares it with balanced free trade's theoretical advantages. But we do not have balanced trade. To continue to adhere to a theory that does not apply to our current situation, while suffering the consequences, is neither appealing nor necessary.

The WTO itself wisely allows departures from pure free trade by a country faced with a significant and persisting balance of payments problem. (Article XII of the WTO/GATT). This article has been invoked many times by many countries. The United States used it under President Nixon in 1971.

Let us move in the direction of the Buffet plan and then work to get back to a world of naturally balanced trade.

Step 2: Encouraging and Supporting Productive Companies -- Creating Wealth in the United States

Productivity appears in both Ketchum goals. Steadily improving productivity makes a richer nation. Discussions of how to improve national productivity typically focus on R&D, innovation, better K-12 education, and improved infrastructure. These things are helpful, but, as I have testified to Congress, unless we change the motivation of our companies, many of these actions will have limited effect. One example: R&D done in the United States by global corporations can end up in their production sites abroad where it creates new and productive jobs.

We need to consider not only the familiar suggestions I have just listed, but also ways to better align corporate profitability with the needs of the country.

Aligning Country and Company

Some Asian countries have well-developed national strategies aimed at the rapid increase of their output (GDP). Part of that strategy is to induce foreign, often U.S., corporations to create highly productive jobs in their countries. In the case of China the area of emphasis has been manufacturing and as a result, we have seen both the resulting cheap goods and the devastating impact on productive jobs in this country's manufacturing sector. An Asian country will work out individual tax and market access arrangements for productive companies that make it *profitable* for the company to produce there. By doing this they align the company's profit motive with *their* national growth goals.

Some economists will argue that these developments in Asia are automatically good for the United States. However, the view that the industrial development in your trading partner can at times be harmful to your country also has a long and distinguished history in economic thought. When there is gain and when there is harm is summarized in a Gomory-Baumol article and spelled out in our book on global trade.

In the United States we do not have the tradition, the knowledge, nor the desire to follow the Asian development path. But there are approaches to aligning corporate and country goals that are compatible with our own history and with what our government could actually do.

We are already using the corporate tax rate to spur R&D -- why not use it to encourage directly the creation and retention of productive jobs? For example, the corporate tax rate could be scaled by the value added (a measure of productivity) per full-time employee in the United States. A company with high value-add per U.S. employee would get a low tax rate; a company with low value-add per U.S. employee would have a high tax rate. The choice of actual rates could make this as strong or as weak an incentive as desired. It could be made revenue-neutral. Note that value added is easily measured; in fact it is measured today in Europe as the basis for their value-added tax.

This approach to rewarding companies for acting in the national interest is completely different from the "national champion" approach of some countries or the deal-by-deal approach of others. It is very American. It would be an incentive not restricted to big corporations; any company that is productive could benefit. The local plumbing business or the little shop around the corner will benefit if they can find a better way to be productive in what they do.

Widely Shared Wealth

The second Ketchum goal mentions the distribution as well as the creation of wealth. For the last 25 years most of the country's economic gains have not been widely shared. Globalization was not the beginning of this trend. It was rather a very large additional step in a journey that started years ago. Let us look back.

In 1981 the Business Roundtable issued a long Statement on Corporate Responsibility in which it discussed companies' responsibilities to its various constituencies: customers, employees, communities, society at large, suppliers, and shareholders. The Statement concluded with the following statement about the American Corporation: "It must be a thoughtful institution which rises above the bottom line to consider the impact of its actions on all, from shareholders to the society at large. Its business activities must make social sense just as its social activities must make business sense."

That was 1981, but today's corporations aim primarily at maximizing shareholder gains. Corporate shares are held overwhelmingly by those who are already wealthy or by those, like top executives, who will become wealthy if share values go up. Corporate leadership today is strongly motivated to cut wages and benefits whenever they can to increase profits and shareholder value and their own compensation. The money saved from wages and benefits comes out of the middle and lower income groups; the gain in profits goes to the wealthy.

This decades-long tendency of workers, and more generally the middle class, losing share in the productivity gains is being strongly accelerated by globalization. In globalization, jobs and their wages leave the country altogether and only the corporate profits remain. Globalization is causing that divergence to occur faster and go further than ever before. Balanced trade is again vital for dealing with this problem.

To reduce these strong natural forces working toward extreme inequality we should obviously consider what can be done through taxes, individual or corporate, and by strengthening the greatly weakened bargaining power of workers. A direction advocated by Robert Scott of the Harvard Business School is to use charters for corporations that require giving weight to other factors than profit maximization. Today in the United States, in contrast to most countries, corporations can obtain a charter and promise nothing in return.

It is interesting that Theodore Roosevelt saw the role of corporations quite differently from the current dominant perspective. When necessary, Roosevelt was willing to influence corporations to act in the public interest. "Great corporations exist only because they are created and safeguarded by our institutions," he stated in his 1901 State of the Union message. "And it is therefore our right and our duty to see that they work in harmony with these institutions."

Conclusion: We are living through a difficult time. But difficult times are also times when change is possible. Our country needs productive corporations that create productive jobs. We have described here two essential things that need to be done to start to align the corporate interest with what the country needs. There is more that can be done, but let us start here.