THE BROOKINGS INSTITUTION

# CORPORATE GOVERNANCE AND LONG-TERM, "PATIENT" CAPITAL

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PROCEEDINGS

MR. WEST: Good morning. I'm Darrell West, vice president of Governance Studies of the Brookings Institution and I'd like to welcome you to this forum on corporate governance and long-term capital, and we are webcasting this event live, so we also would like to welcome our audience around the country and outside the United States.

We have set up a Twitter hashtag at #PatientCap, that's #PatientCap, all one word, so viewers can post comments and ask questions and when we come to our Q&A session we will take questions both from the people in this auditorium as well as our webcast audience.

Not long ago, many American investors held that innovation took a long time to develop and that capital needed to be patient in order to realize a reasonable rate of return. Today, however, the converse of that seems to be true. There's a great emphasis on short-term monetary returns and the need for immediate gratification in capital investments.

This limits the time for innovation to actually take hold and alters the incentives for corporate action.

This morning we're going to discuss how things have changed in corporate behavior and in the investment horizons and what it means for society. This is part of a new project that we have launched on the purpose of the corporation. We are undertaking research and quarterly forums on various aspects of corporate purpose.

Our goal is to bring together leaders, including lawmakers, corporate executives, university leaders, and representatives from the nonprofit sector. We want to promote a broader discussion about the purpose of the corporation and inform policymaking and public discussions over the next few years.

And we'd like to thank Bill Budinger for his generous support of this project. He's helped us think about the subject and consider what we can do to improve the future of our country. He is not here today, but he is watching via the webcast, so, Bill, thanks for all the help that you have provided and we're very grateful for the support.

To address these topics we have put together a distinguished set of speakers. We're delighted to have Senator Byron Dorgan here. He is the former Senator from North Dakota. He served in the Senate from 1992 to 2011 and in the House from 1981 to 1992.

Since leaving the Senate he's become Senior Fellow at the Bipartisan Policy Center and Senior Policy Advisor and co chair of the Government Relations Practice at Arent Fox.

His last book, which is very relevant for our topic today, was entitled *Reckless: How Debt, Deregulation and Dark Money Nearly Bankrupted America* and he also told me this morning he has a new book coming out on March 27th, so it's soon to be hot off the press. It is a piece of fiction entitled *Eco Thrillers* that deals with energy, which is one of the Senator's areas of interest.

And I also want to point out that there's a video of the Senator making a speech on the Senate floor from 1999 that now has gone viral and is attracting a lot of attention because it was such a strong forecast that he made at that time. This is the time when the Senate was considering the repeal of Glass-Steagall and he said, "I think we will look back in ten year's time and say, 'We should not have done this', because we forgot the lessons of the past and that which is true in the 1930s is true in 2010." So, he was off by like maybe one year on that prediction, but that was a pretty good prediction.

We're also pleased to have the Honorable Jack Jacobs here with us. The Honorable Mr. Jacobs is Justice of the Supreme Court of Delaware. He was

appointed to the Supreme Court there in 2003. Before his appointment he served as Vice-Chancellor of the Delaware Court of Chancellery. Since 1985 he held that position.

He also has practiced corporate and business litigation in Wilmington, Delaware since 1968.

In addition to his judicial activities, Justice Jacobs serves as adjunct professor of law at the New York University School of Law, also at the Columbia University School of Law, and at the Widener University School of Law.

He has authored and co-authored numerous Law Review articles addressing various aspects of corporate law, mergers and acquisitions, and corporate governance.

He is the author of an outstanding 2011 paper in the Washington and Lee Law Review entitled *Patient Capital: Can Delaware Corporate Law Help Revive It?* And he'll talk a little bit about what he said here -- said in that paper here today.

Lawrence Mitchell is dean of the Case Western Reserve University School of Law. He also serves as the Hostetler-Baker Professor of Law there. He's written extensively on various aspects of law, economics, and finance. He is the author of a 2007 book entitled *The Speculation Economy: How Finance Triumphed Over Industry.* Previously he was the Theodore Reinhardt Professor of Business Law at the George Washington University Law School.

Our last speaker is Judy Samuelson. She is the executive director of the Business and Society Program at The Aspen Institute. She works on issues related to corporate responsibility and the relationship between business and long-term societal health.

She spearheaded the creation of The Aspen Principles, a set of guidelines to spotlight what she calls "short term-ism" in business and capital markets

and she also helps to promote longer-term focus by companies and institutional investors.

So, I'm going to start with Senator Dorgan. I know that you have served on the boards of both public and private companies and you have noted that there seems to be a lot less patience in public companies. Why is this the case and what issues does this raise for society?

SENATOR DORGAN: Well, first of all, thank you. It's nice to be here. And this is a very interesting and challenging subject. The difference between private and public companies is very substantial. A public company has a responsibility to its shareholders, in the filing of a 10-K, for example, at the end of a quarter describing what was their revenue, what's their EBIDTA, what -- how did they perform in that quarter is often dispositive about what happens, what's the assessment of the shareholders in the marketplace about the future of that company.

So, they're very focused in the short-term.

A private company, in many cases, is often financed by venture capitalists. They see a good idea, it attracts some venture capital, they are less risk-averse, they are very interested in having more patience to see whether this idea will be the next Google or the next Facebook or the next whatever.

So, there's a very big difference in terms of both patient capital and also governance in the public versus private companies.

My acquaintance with this subject called governance dates back in Congress especially to, first of all, the S&L crisis, which I was involved in investigating. I led the investigation of the Enron collapse in the Senate and chaired the hearings of the Enron collapse, which had major questions with respect to governance. And then the issue of the financial carnage over the last few years. The book I wrote called *Reckless*

would give you a pretty good idea of how I viewed all of that and what I think contributed to it.

But these are some of the largest, spectacular, devastating corporate train wrecks in the history of our country and one of the questions everybody should be asking is, how on earth could that have happened?

Who was supposed to have been providing oversight, governance? Who was supposed to know what was going on? Who in Enron would have known that there was a criminal enterprise in part of this big company that was bilking people out of billions of dollars?

The same is true with respect to the financial circumstances in recent years. Who on earth should have known what was going on with some of the biggest financial institutions in the country that were effectively coming up to a craps table at a casino and just putting their capital down and just betting on red or betting on black?

It was unbelievable to me, when you get into the middle of all this and see what happened and then asked, well, who was watching the store? Who was minding the store? It was all about money, all about greed, and all about trying to find a way, in the short term, to make a quick dollar even at the expense of corporate ethics and honesty.

So, anyway, I wrote a book about it just to get it off my chest, but I think this kind of a discussion and the work that's going on at the project at Aspen and elsewhere, of how do we really think through this in a constructive way to evaluate not just what happened, but what kinds of things can prevent it from happening again?

Each time something big happens you have a remedy, Sarbanes-Oxley or Dodd-Frank. But is the remedy the right remedy at the right time? Probably not. So, I think these kinds of panels and the work that's going on in discussions all around the

country are very, very important in terms of our economy going forward.

MR. WEST: Thank you. Justice Jacobs, you've written about the importance of patient capital and some of the economic and social benefits that come from that, but yet when we look at a lot of companies, they do seem to emphasize short-term financial returns. So, why is this? And what types of issues does it raise?

MR. JACOBS: Well, let me join Senator Dorgan in thanking the Brookings Institution for inviting me here. It's a great honor. It's not my normal venue. Judges don't usually appear at conferences like this.

But to answer your question, you know, although certainly legal behavior and short-term greed have played a role in the sorts of things that we've been seeing, where I -- the way I see it, there are major structural changes that have taken place over the last 40 years that are the primary cause of what we call short-term-ism, the disappearance of patient capital.

After World War II, and until the early 1970s, basically the direction of the economy and the way corporations were managed were determined exclusively by the boards and managements of our public companies and the financial community, the investment community, was the tail rather than the dog. That is, their concern would be with how to raise capital for these public companies and how it ought to be traded and the like.

What has happened since the 1970s is a complete reversal of that trend, that is to say, the dog is now the investment community, the tail are the managements of our public companies, and because the view or the perspective of the institutional investor community has completely changed to a short-term focus rather than a long-term focus, that is the source of the problem.

Let me be more specific about that. Institutional investors today control

roughly 70 percent of the shares of the public companies in the United States. The managers of those institutions are compensated on the basis of short-term capital gains from their portfolio companies. And it's a documented fact that most institutions don't even hold the shares of their portfolio companies for a long period of time. A year is a long time. A more typical period is six or seven months.

The stock price of the portfolio companies is measured on a quarter-to-quarter basis and the fluctuations that are caused by analyst reports that will recommend a sell if the company doesn't perform exactly as its projections indicated it would, create all sorts of instability and pressure toward, you know, basically getting in and out of a stock very quickly.

So, the investors that own most of corporate America is not looking -- are not coming at this problem from the long-term and that puts pressure on the portfolio companies and the managements of the portfolio companies to produce returns for the short-term rather than the long-term, which is the opposite of the way it used to be.

Not only are the companies under pressure from the investment community to produce short-term profits, but also the managements of those companies have no financial incentives to resist those pressures. Most executive compensation packages have a large, built-in component consisting of stock and stock options.

The financial incentive to manage the firm is basically to do it in a way that keeps the stock price up, or at least doesn't do something that results in the stock price going down because that will have an impact on executive compensation.

And all of those are forces that lead to management for the short-term. That trend is exacerbated by institutional investment community successes, recent successes, in exerting influence, direct influence, over portfolio companies in a more formal way, and that is by invoking corporate law strategically to change the governance

policies of portfolio companies to make the company less director-oriented and more shareholder-oriented.

The examples of that are a spate of shareholder resolutions, generally at annual meetings of public companies, to adopt bylaws to limit the board's power to adopt takeover defenses, to limit the board's power to require proxy access in order to elect dissident slates of directors every year, and to mandate reimbursement of proxy expenses, all of which are permitted and they're perfectly lawful under the corporation law of Delaware and most other states.

And lastly, at the federal level, Sarbanes-Oxley and Dodd-Frank have indirectly validated the movement in this direction, although that was an unforeseen consequence, by mandating certain forms of governance for all publically held companies and creating a divide between independent directors and management.

MR. WEST: Thank you. Lawrence, you have written the book *The Speculation Economy.* You've talked about how you think speculating has replaced investing as the principle goal of shareholders. What do you think are the problems that have created this emphasis on inpatient capital?

MR. MITCHELL: Well, first, again, like my co-panelists, I want to thank Brookings for addressing this issue today, which I think is probably one of the most pressing issues for the sustainability of America's future because it involves our ability to conduct capitalism, which is the production of goods and services, creating sustainable, transferrable wealth, not the short-term creation of liquidity for the sake of reinvesting in markets that ultimately, predictably, fall apart and produce very little.

So, what I'll talk about for a couple of minutes, I agree with everything Jack just said and, in fact, in 2001 I wrote a book in which I talked about a lot of the incentives and a lot of the factors that drive short-term-ism, but it caused me to wonder

about where it came from, which led to the book you mentioned, Darrell, *The Speculation Economy,* which is an historical work which traces the sources of these problems really back to the 1890s, which was when the American stock market first became a broad, widespread public market.

And what I found taking that historical story up to the present, and I agree with Jack, it's about 40 years, I would actually push it back about 60 years to the 1950s, early 1950s, there's a lot I could say about this.

But what I want to do is isolate two underlying causes or two underlying problems that give rise to impatient capital. Just for introductory purposes I think they're two of the most critical problems.

So, the first is the sources of capital. Most people believe that the primary source of capital or, at least, if not the primary source, that equity capital finances American industry. Nothing could be further from the truth.

Starting -- up until the 1960s, American corporations retained, on average, about 61 percent of their earnings going up sometimes to as high as 70 or 80 percent of their earnings, pay out the rest in dividends and then financing with some debt, but most financing was done with internal equity. And that point, you could talk about the stockholders being the owner of the corporation, and of course the stockholder controlled the corporation, as the stockholder still does, as Jack says, unfortunately, institutionally.

But if you start tracing this information, this financial structure from the early 1960s on, you see a decline in retained earnings of about 60 percent in the early 1960s to 3 percent in 2010. Well, that means -- and it came back up to about 10 percent in the past couple of years, so who's financing American business? If, basically, they've given all their savings away, where does it come from?

Well, the answer is, it comes from debt and that debt is largely off

balance sheet. It was recently as five years ago, approximately one-third of all productive capital was at least off balance sheet, and that's before we even talk about other forms of off balance sheet financing.

So, basically what we have here is a disconnect. We have a corporation not only controlled by the stockholders, actually now controlled by the stockholders in the form of institutions, with management elected by the stockholders, but with risk capital being put up by creditors.

What are the incentives? The incentives are to gamble with the risk capital because it doesn't belong to the people that control it and I think that that is an extremely risky and dangerous proposition when you're talking about long-term industrial sustainability.

The next, and a little bit more complicated, thing I want to talk about is the sources of gains from stockholding. Again, Jack talked a little bit about the velocity of trading and the shift from dividends to capital gains. That started happening in the 1950s, it really took off in the 1960s during what are called the "go-go years" when mutual funds and particularly high flying speculative mutual funds started to increase, but the question is, why is this a problem? Well, theoretically, capital gains, the increase above the price you paid for what you sell your stock for, is the discounted present value of the future earnings of the corporation.

All right, well, let's compare this with dividends. Dividends are cash. You actually have to own the cash to pay the dividends. So, what happened is in this period, stockholders began to find that they could earn more money by selling their stock. Not a problem at first, because, remember, in the 1960s, 60 percent of the corporation's financing was retained earnings. So, capital gains actually was a true increase of the value of the corporation internally with some of it coming from discounted future gains.

But what happened in the market was this: as recently as 1980, well, at least to some of us that's fairly recent, the turnover on the New York Stock Exchange was 36 percent. Not that many shares were trading hands. It's like 130 percent today and what does that mean? What does that show? Well, not only does it show impatient capital, but it shows that stockholders are trading for the purpose of reaping capital gains. And where do those capital gains come from? Well, they're not coming from discounted present value of future earnings anymore; they've totally exceeded that amount because the trading prices are so volatile and so high.

So, while it's true theoretically that that might be the case, in practice the velocity of trading, which has generated higher increase in stock prices, has basically created a situation where the capital gains seller is, in effect, shorting the future earnings of the corporation, short selling the future dividends.

What does this mean? This means that at the kinds of multiple stock trades now, it's going to take most operating corporations basically to eternity to earn out the capital gains prices that the stock is being sold for today, which is to say that the profits of future generations are being stolen now for consumption now. That's really scary.

That's all I'll say for now.

MR. WEST: That's a pretty good benediction right there.

MR. MITCHELL: Amen.

MR. WEST: Judy, so we've heard from several of the speakers who diagnosed the problem, talked a little bit about how we got to this situation. You've been working this area for a long time; you've been very thoughtful about it. I'm just wondering, what do you think we can do about some of these problems and what is it that would actually produce change in this area?

MS. SAMUELSON: Excellent questions. I think it's useful to go back and talk just for a second about why this is such an important problem. I'd one up you only once. I wouldn't say it's *one* of our most important problems, I would say it is the singular problem of our era.

MR. MITCHELL: I was trying to be moderate.

MS. SAMUELSON: How do we align business with the long-term health of society? We live in an age -- business is the defining institution of our era. It is important that it be aligned with society for two important reasons. If it's not, we get Enron, and when it is, we bring the power of business and the capacity -- its global reach in distribution systems, its incredible talent and problem solving skills, we bring that capacity to bear on the problems that we need business to be working on. So, that's the goal. Right?

So, how do we get there? I would say that the two questions here, one is, like, what can we do about this problem? I'd say that there's a lot of agreement on that. Some of it has been driven by work that we've done, but we've worked closely with organizations like CED, here, Elliot Schwartz, I see, is here.

There's a number of other organizations that have been very involved in this issue for a long time. There's a couple of documents if you want to read more, but I'll just mention a couple things. But there's both a document here that prescribes what it is that businesses can do themselves and what capital markets can do from the powers that they already have, and there's a prescriptive piece that talks about what are some of the policy solutions that are critical.

But basically it comes down to incentive systems, and so I agree with what Justice Jacobs said about the importance of compensation and the alignment of interests here. And so a lot of this behavior that we're seeing is driven by the fact that we

now live in a system where it's okay for the managers of businesses to -- we reward them by actually encouraging them to bet on the system as opposed to just earn out the benefits of their hard labor through productivity and gains in other respects.

So, one book I would recommend for this group, if you haven't looked at it, which sounds like it's quite aligned with the one that you wrote, is *Fixing the Game* by Roger Martin, which talks about, if you think about the NFL and football, it's a great analogy. We don't allow the players or the managers or the coaches or the doctors or anybody else who has anything to do with the game on the field, we don't allow them to then turn around and bet, you know, in Vegas on the outcome of the game.

If you think about it in business terms, that's essentially what's going on. We encourage it and we think that's a fine way to compensate people, and so then you get the kinds of -- we don't get unintended consequences, I'd say, the system is very much designed for failure today.

So, what do we do about it? The solutions land kind of in a few areas. I mean, one, if you start with what businesses can do, they need to move off of this system of thinking about -- communicating about business only in terms of the earnings per share in the most discreet measure of business success around its financial return and forecasting that number and communicating with the market to drive to that result, and start thinking more about, what are the hallmarks of my business, what makes it successful over the long haul, and what are the metrics that I need to follow that are the best early warning system of whether or not we're on track.

Whoever it was who said -- I should know this and Bill Budinger, if he was here -- would be in the room would be telling me who it was who said it, but the idea is that profits are basically oxygen, right? You need them, of course, to have the system run effectively, but they're like kind of a traffic signal about how well you're doing.

They're not the kind of DNA of what actually makes the business succeed and it's not the most important metrics to keep your eye on.

So, that's one big sphere there. The incentive systems all fall from that. Are we paying our executives, in fact, aligned with what are the kind of metrics that are most important to a long-term success of the company?

And the other sphere is ideas that kind of drive this behavior from the tax and the regulatory standpoint and the ideas there are pretty straightforward. And one is, do you skew the cap gain tax, again, to really, as it was under Ronald Reagan, to really reward long-term holding? Long-term is now considered one-year under the cap gains tax, I believe. The differential is not that great. What might the cap gains tax look like if we really rewarded the long-term holders rather than the traders and gamblers?

And then there's trading tax, I mean, that's a very controversial idea. Any tax idea is controversial today, but the idea of throwing some sand in the gears and actually, you know, it wouldn't affect those of us in the room that are saving for tuition and retirement, but it would affect people who are basically at the gambling end of the system so that they would have to pay a very fractional tax that would add up a lot if you're basically in the business of gambling as opposed to the business of investing.

And then, finally, reconnecting the ultimate investor, you know, those of us who are sitting here who, on a daily basis, are not managing our portfolios, how do we connect those back to the people that are making decisions about what is the stewardship relationship between those who ultimately are deciding how our money is invested and what our needs are as long-term investors?

So, those are the two basic categories. The question is: how do you bring about change? I'd say there's a lot of agreement about what to do about it. If people are concerned, there's a lot of agreement. How do you bring about the change

brings us back to a question of leadership. And that's a lot of what we do at The Aspen Institute on this question.

But let me just also say is there's a couple of myths I think we need to explore, one is that not all shareholders are the same. We love this idea of democracy in the United States of America, but I don't think corporations are democracies. I don't think they're designed to be democracies. That's certainly not how decisions are truly made. Shareholders are not really owners of the firm. They have a residual claim or they own a share of stock. They're not really the biggest risk takers. You know, they're trading in and out of the stock. Maybe the guys who first put up the capital in order to allow the company to invest and to create its business model, maybe they took real risks.

But those of us who come in later and are trading in the public markets with deep liquidity are not taking the kind of risks that maybe the real -- the employees or other stakeholders of the firm are taking, the community in which the company resides.

So, that whole area of why are we giving the kind of power that we are to shareholders and this almost conflating today of shareholders and the middle class, as if somehow it's all one and the same, and I think the statistics would show something different than that.

And then the other thing here is really to get back to the question of purpose of the firm. I'm a little scared to say this kind of thing with so many legal scholars to my right over here, but our reading of it would be that neither the law nor business practice, in fact, is aligned with this ideology that the purpose of the firm is to maximize shareholder value or maximize profits.

We think the Delaware court, among other courts, gives great discretion through the business judgment rule, to boards to be able to mitigate, and this is what boards do at their best is to mitigate the multiple objectives and requirements and

expectations that we have of public companies.

And that resides in boards because businesses, by nature, are exceedingly complex and you need to be very close to the enterprise to be making wise decisions that stand the test of time.

So, we come back to three principle questions: What is the purpose of the firm? How do you measure success and over what timeframe? And who needs to be at the table to make high quality decisions?

Who's able to put these questions on the table takes us back to business leadership again, and I think what we are suffering from today is a real lack of business leadership and the willingness, with business, you know, in another era of this country, were the ones who were really helping us think long and think about what's in the long-term health.

Business is -- commerce in the United States is what makes the melting pot melt. That's what traditionally has brought us together as a society and I would say today we've lost that sense of aligned interests, and we need courageous business leaders to be at the table and to take the kinds of risks that sometimes we see more from European firms and the willingness to stake and say, this is the business we're in, but there is also hope at the other end, that companies like Google and Facebook, I think, when they go public, are entering with different kinds of contracts with their shareholders and they're trying to maintain this longer-term view.

So, I'm hopeful, but there's a lot of work to do.

MR. WEST: Okay. I'd like to throw out another question for everyone on the panel, so each of you can jump in. It really builds on Judy's comments about the need to change the incentive systems. She threw out various ideas that might possibly make a difference and be helpful, changes in the compensation system, changing the

length of the capital gains tax. She mentioned the Roger Martin idea of the trading tax. There could be governance reforms.

I'm just curious, for each of you, what do you think would make the greatest difference in dealing with some of the problems in this area? Maybe we can start with Senator Dorgan.

SENATOR DORGAN: Well, let me answer a question you didn't ask. (Laughter)

MR. WEST: This is no longer the U.S. Senate, Senator.

SENATOR DORGAN: I've been watching the debates.

You know, first of all, I agree that there are perverse incentives in our tax laws that create perverse results, and some of the suggestions about capital gains, and so on, all of that is something we should talk about.

But let me just go back to a point that Judy made, because I think it is central to this question. Judy, you talked about the need for an alignment of the business interests having an alignment with the interests of society. And in some ways, I agree with that, as a matter of fact, but it is completely way outside the current wave of opinion out there and public discussion and debate.

The current public discussion and debate is, just get out of the way, get out of the way, deregulate and get out of the way and let the private sector do what it does best, that's the free market system. And that's the prevailing thought. In fact, much of this campaign will be waged on that general subject.

And, I mean, I disagree with that. I think there's a very important need for effective regulatory oversight, but the other side of this is, when you talk about our business interests being aligned with our society interests, it is also the case that many businesses these days, although perhaps chartered in Delaware, are not just American

businesses. They don't see themselves that way at all. They don't say the Pledge of Allegiance at the start of a board meeting. They are international corporations.

Their interest is in China, their interest is in Germany, the United States, Brazil, and so on. That persuades them to have an entirely different view of what their responsibilities are, how they have to do business in the various areas, and how they would best seek the maximum profit opportunities around the world.

So, I just wanted to mention that. I found your comments very interesting and comments that I agree with, but it is the case that we now live in a political climate, strangely enough to me, a political climate just in the shadow of the most spectacular financial collapse since the Great Depression where you think the American people would be clamoring for additional and more regulatory responsibilities.

I voted for Dodd-Frank not because I thought it was an important piece of legislation. It was necessary to do but was timid; it was a baby step in the right direction. I couldn't get a vote on an amendment that says, "If you're too big to fail, you're too damn big. Too big to fail ought to be abolished. If you're too big to fail, take them apart." I couldn't get a vote on an amendment that says, "If you've got big financial institutions trading on the proprietary accounts in naked credit default swaps, stop it. It will be against the law as it is in Germany."

So, Dodd-Frank was passed, with my vote because it was a step in the right direction, albeit a baby step. And let me just finish by saying, I thought, in the shadow of what has happened in the last few years, there would be this public clamor to say, let's really do regulatory reform the way it ought to be. I don't want over-burdening regulations on business, but I want the right and the effective regulations on business so that there is proper governance and proper responsibility and accountability.

MR. WEST: Judy, since he referenced your remarks I want to give you a

chance to jump in.

MS. SAMUELSON: Yeah, and I think I'll try to respond to your question at the same time.

MR. WEST: Thank you.

MS. SAMUELSON: No, he gave me the on-ramp, so he gets credit.

I don't think the great American people are the best barometer on this question, this question of, you know, let business have their way, free enterprise, it's all about -- you know, the markets are the leader.

I think what we're hearing is money in politics, and so the point I would go to, I think the single most important thing we could do is divorce our political system from the money of -- I don't even want to call it special interests -- I mean, let's get the money out of the political system because I think that's why it's hard to get the vote you needed to get on the floor to amend Dodd-Frank.

I don't think it's because the great American people are saying, no, no, no, don't mess around with the business sector. I think it's because the business interests that don't want the banks broken up are putting a hell of a lot of money into the coffers of the system to make sure that that doesn't happen.

That is so tightly aligned, I think, with the problem of getting traction on reinvesting in a longer-term view in our society that it's hard for me even to divorce these two.

SENATOR DORGAN: If I might just make one sentence here. When the dust settles at the end of 2012, I think the impact of the Citizens United decision by the Supreme Court and the development of Super PACs, will be seen, in retrospect, as one of the most significant corruptions of American politics in 200 years. So, again, we're moving in the wrong direction rather the direction you suggest. And I support what you

just said.

MS. SAMUELSON: Could I say one more thing? I think though that it may put it in a more hopeful vein, which is if you look at the generation -- some of you guys in this room are of that generation, and I didn't mean -- I meant the ones to your right here, sorry.

The Millenials are all over this question of private enterprise, but they deeply combine it with social values and environmental values. So, they believe deeply in private solutions to public welfare because they've grown up in an era in which we've put such a premium on that.

But for them, this is a very connected question and they are very anti big business, and we're finding people in business schools are actually very reluctant to move into the business sector where we most need their talent and their ideals about how to manage better in business. They want to all start little start-ups, you know, these social enterprises to solve the world's problems, and that's not going to do it.

So, I think, we have hope that actually these things can come back together, but it may take a generation.

MR. WEST: Okay, I want to get Jack and Lawrence in this and then we'll turn to the audience and get your views. Justice?

JUSTICE JACOBS: Okay, if I remember the question correctly --

MR. WEST: Remedies, what do we do about this?

JUSTICE JACOBS: -- what can we do about it? And I'm going to try to address that but I just want to preface it with a couple of words about where I'm coming from on this.

You know, America is in a global competition, economic competition with countries from all over the world, particularly the developing companies, and our country

is now losing out to companies that originate in other societies because those societies have lower labor costs, they've got lower regulatory costs, and it is not realistic to think that we're going to be lowering our own costs to compete at that level.

So, the question is, what is the advantage that the United States has in this global economic competition? I believe that our main advantage is the ability to innovate that is to invent and then develop and distribute in the market products that will be so attractive to the world market that they will be able to compete regardless of price by their very nature.

The problem is: how do we finance that? And that gets back into the area that Dean Mitchell was talking about. In the old days, we -- we being the American business community -- financed it by reaching into their own savings, that is, their retained earnings, and less into the capital markets, and as a consequence of that, business entities had control of their own futures.

We've now seen a reversal of that. In order to finance innovation in today's environment, we need patient capital. Why is that? Because to innovate, that is, to develop an idea and turn that idea into a saleable product, takes time and during the time that's required to do that, the capital that's invested in the development of those innovative products, will not see a return.

If you have a world, which we do, where everyone who's investing wants to see a return in three months, you're going to have problems raising capital that will sit still for five years or more, and so the challenge is how can our society reverse this trend, and it's a very strong trend because it would involve, to be metaphorically, swimming upstream against a very strong current that's going the other direction. That gets to this issue of remedies.

From a very broad, big picture standpoint, you can address that in one of

two ways. You can try to change the perspective and the incentives of the investment community, that is, somehow convert them into long-term investors, that are willing to accept returns over a long period of time, or -- and/or, you can try to affect the reforms at the company level and at the level of the managers of those companies.

My own particular view is that in order to have some systemic big picture change that would operate directly on the investment community would basically involve federalizing a lot of our institutional -- that is, our securities and financial institution network, including all of the stock analysts and people that make recommendations. We could talk for hours about how that might be done, but the bottom line, in my opinion, is that's just not going to happen in our lifetime. It's not a politically doable thing.

And therefore, it's more realistic to be thinking about reform at the corporate level and that would involve less top-down federal changes. It could be done more easily at the level of changing state law and in designing compensation packages that will reward or incentivize managements to be planning for the long-term.

In the piece that I wrote, the changes that I proposed are very modest, and I'll just take one minute. One of them would be to amend the corporate statutes of our states, including my own, to allow companies to elect directors every five years rather than every year, and to -- basically to make it -- to prohibit removing directors except for cause.

What that would do is free up boards to plan for the long-term without the year-to-year pressure of institutional investors threatening proxy contests, basically, to remove the incumbent board because they're not managing in a short-term way the way the investment community would like them to do.

Another change that could be made -- and, by the way, that would require the SEC to cooperate by changing the listing standards so that companies that

don't have -- so that companies would no longer be required to have an annual election in order to be listed. But that could be done -- it's more easily done administratively than legislatively through Congress, changes in the tax law to make it attractive tax wise to channel investments into longer-term areas.

There are -- and basically, to change the incentive compensation packages for corporate managers, and that, there is already thinking being done along those lines.

A few days ago I was sent an article, an interesting article, by Patrick Bolton and Mr. Samaris talking about the development of loyalty shares, what they call L-shares that would reward managers by giving them, at the end of a longer period, an option to acquire more stock. It's basically a balloon reward, but there are all sorts of ways that that can be done.

So, you know, my own proposals are very modest. I'm not a policymaker. I'm sure others sitting here can come up with bolder ones than I have, but I think the changes do have to be from the bottom up and if there is going to be more systemic changes, there has to be the political will to do it and I think that's going to require creating a demand from the bottom up that something be done at a higher level.

MR. WEST: Okay, Lawrence, what changes do you think?

MR. MITCHELL: Where to begin? Well, I guess I get some prefatory remarks too. So, what I want to begin with is, I want to ramp up the issue a little bit because listening to the discussion so far has reminded me of a question I often get when I lecture on what I call financialism. And that's the question of, in a global economy, maybe what the market is telling us is that certain nations specialize in certain kinds of things. Maybe it's innovation, but what I'm frequently told is, well, the United States specializes in finance. We're good at that.

Well, there's a question about how good we are at it, but in any event --

MS. SAMUELSON: Yeah, all evidence to the contrary.

MR. MITCHELL: The argument that I've made repeatedly in different forms and different publications and speeches is that with the current financial system, what we've basically done is we've stripped out the productive capacity of American industry, which -- and, by the way, just as a fun fact, the last time I looked a couple of years ago, on average, about 50 percent of the balance sheets of operating corporations were comprised of financial assets, not property, plant, and equipment, financial assets, which tells you that American industry is into the business of finance too. There are a lot of reasons for this, not the least of which is that CEOs increasingly come from finance as their background, not engineering, not sales, not marketing, not even law where they used to come, but from finance, and you do what you know how to do.

But what all of this does, to just take this up a level, is it creates an issue of national security because if you stop innovating, if you stop manufacturing your own goods and services, yes, it's true, perhaps, that China depends on us as a market for their products -- I'm not necessarily saying we have to replicate the Chinese economy, which is kind of like the American economy of the '40s or '50s, but once you give up the capacity to do that, you are reliant on the good will of other nations and their self interest to supply you with what you need.

You can't survive as a nation on finance alone, and one could certainly see a circumstance in which, say the Chinese government decided that they would take some serious losses for a few years, sell to other countries, and basically starve us out of existence. What are we going to do if we don't know how to make and do our own things?

Which leads to the question of how we, not necessarily recreate the 40s,

50s, and 60s, the golden age of American industry, but how we recreate a more balanced, sensible, productive economy. And the answer, as I think everybody's been saying, is all about the incentives.

When the Senator talks about regulation, I think you were talking a lot about regulation as prohibition, and I think regulation works best when regulation drives the incentives.

There are a couple of things that ought to be prohibited. I agree with you. I think the stupidest thing Congress has ever done in our history, financially, was Gramm-Leach-Bliley and repealing Glass-Steagall. But it's far more politically palatable and it's certainly more in keeping with the way we run our nation to design incentives that direct good behavior, virtuous behavior, and I've been hawking this idea since 2001. I think capital gains tax reform is what it's about, but it's not as simple as an on/off switch.

To really create the proper incentives, what you might do is seriously penalize short-term trading and then have a sliding scale of capital gains taxes over a five or ten-year period where you might even result in tax forgiveness if you hold the security for the really long-term, so what you do is you build in the cost of short-term trading into the investment decision in the first place. If you know you're going to be turning it over fast, you better be sure you're going to be making a lot of gains, and it's going to be hard to make enough gains to compensate for your taxes.

So, that's one thing. Another -- and this is a result of regulation, not deregulation -- was the 1993 tax law that created the incentive for corporations to compensate their executives with stock. You know, prior to that time, most executives were employees, they earned cash salaries and if they did really well they got cash bonuses.

Today executives demand a percentage of the equity as their

compensation. They're not employees, they're partners, but they're partners with incentives, and I think you're right, the shareholder is not a monolithic thing, shareholders are very different. Their incentives are aligned far more with short-term than long-term investors.

Cain has told us in the long-run we're all dead, well, the average tenure of a CEO is about five years or less these days, and if you know that your compensation is going to be determined by your stock price, then that gives you an awfully powerful incentive to work short-term to determine your own payday, get that stock price up, and since we know there's no shame left in America, say you leave a bleeding business, but you leave it with a really fat paycheck and you don't really have to worry very much about your own future.

This is also true in the compensation of investment professionals, money managers, right? I mean, the idea that you're compensated on a quarterly basis for your capital gains, when you have the power of what really is a small handful of institutions putting pressure on corporate management, which already has the incentives to raise the stock price, to do it even more, is a very dangerous set of circumstances.

So, if you tax the hell out of them, at least if they don't behave like long-term investors, which was the idea in the first place -- I mean, back in the early '90s, everybody was celebrating the rise of the institutional investor saying, finally, the stockholder has exerted its power. We now have somebody who is going to act on behalf of the stockholder the way we envision stockholders acting.

I take a little pat on the back here, I published one of the only -- maybe the only -- article during that period that said, no, bad idea. Well, it was no, bad idea, because those compensation structures really produced the same kind of perverse return incentives.

So, although there are lots of different ways of resolving the problem -- and among them, we haven't talked about this at all, is accounting and the way you deal with accounting issues because you manage what you measure, so if we measure something different, and longer-term, rather than quarterly EPS, we might actually get somewhere. Corporate governance structure, I used to think Delaware did the right thing by pushing independent directors. I don't believe that anymore. Independent directors know one thing, they know stock price. Inside directors know the business.

So, a well-intentioned reform, that of independent directors, actually wound up creating an incentive set -- how do you stay as the director? Well, you keep the stock price up, and that's what you know -- that causes a really serious problem.

So, there's some other kinds of solutions, I think maybe of a five-year board term, is a good one, but I also think that making sure that we build in financial penalties for what I think we all can agree is irresponsible financial behavior, certainly irresponsible when you're talking about the kind of speed trading that computers do on tiny upticks to get all the nickels off the table. I mean, that's not even investing.

You get some PhD from Wharton to program your computer and the computer's doing the trading for you, but the stock price has a profound effect on managerial incentives. So, I like taxation a lot.

MR. WEST: Okay, thank you. Let's move to the audience. We'd be happy to take questions. Right there on the aisle is one question.

And if you could give us your name and your organization, and if you could keep your questions brief just so we can get to as many of you as possible.

MR. SHERRETTA: Okay, Robert Sherretta. I'm president of International Investor and also partner with International Board Governance and Investment Advisors.

Let me begin by throwing a few quick barbs and there will be questions. One is at Brookings. I think this is a great idea for a forum, but I see that we have an academic, two lawyers, and a former senator. No corporate directors on this panel. It would have really been nice if we had a few. I know maybe you tried and they weren't available, so, believe me, I understand that.

But let me also throw some quick questions out. Senator, there was a movement call Occupy Wall Street, so there was some public outrage expressed. The problem is, sometimes, you don't get the media and others to pick up the story until it's too late or they just denigrate and maybe criticize those who are in these kind of resistance movements.

The other issue I'd like to bring up, I guess, is with Mr. Jacobs. Mr. Jacobs, our travels around the world tell us the entrepreneurship and innovation is taking place everywhere. And there are nations and peoples dedicated to take the lead away from us in many, many key areas. This idea that America is always going to succeed and stay at the top because we have some magical mental skills in this area, I think, is a false one. And every time I hear it I'm ready to choke, frankly.

So, I'll leave it at that, let other questions get in, but I'd like to hear two responses to those two questions, at least.

SENATOR DORGAN: Well, let me defend Brookings. I am a member of a board of directors of a public company. So, you're not quite accurate on that.

MS. SAMUELSON: There is just one on the innovation front, of course, innovation exists in lots of places, but there aren't many other countries that would, when you survey the CFOs of those same companies, would have such a high percentage that would say, we would cut R&D in our company before we would be willing to miss our quarterly projection. And so the survey research suggests that something like 85, 88

percent, I don't know, somebody here may remember the statistic, of corporate managers say that they will forego -- they will cut research and development, they will cut investment in a net present value producing project before they would be willing to miss this quarter, the next 90 days earnings report.

That's a problem, because if we're at least going to stay competitive, we obviously have to be investing in R&D.

MR. MITCHELL: I'd like to underscore that for a second, if I could. The last time I looked at this, just before the crash, the three-year average in the end of September 2007, the S&P 500, on average, spent more money in stock buy backs than they did investing in property, plant, and equipment.

You want innovation, you've got to invest in property, plant, and equipment. You can't invest in stock buy backs, which does one thing and one thing only, and that raises the stock price.

JUSTICE JACOBS: Well, I take it from the speaker's comment that you agree that one advantage that this country has is its ability to innovate, and you're quite right, that American companies throughout the world are doing it and attracted to it, and if we didn't have an advantage, then why would other companies from other societies try to copy and even steal what we have?

My only point, and perhaps I didn't make it well enough, is that we need to clear away the obstacles to that, we need more of it, and to do that I think there has to be a change both -- well, let me say it differently -- not long ago the thrust of policy used to be to protect shareholders from their managers. I think at least in this area we need to protect the managers from their shareholders.

SENATOR DORGAN: Let me just make, on the second point -- the first book I wrote was called *Take this Job and Ship It.* It addresses a number of these issues.

But let me just condense it to say, simply, in my judgment, innovation -- we are innovative, that's true, but that's not going to retain the kind of economic strength we need. We will not long remain a world economic power without world class manufacturing capability, and if we don't focus on that, we're in big trouble in the future.

JUSTICE JACOBS: Could I just footnote that? I couldn't agree more. As a society we have to do more than just prepare each other's tax returns and represent each other in court. Somebody's got to make something and sell something.

MR. WEST: Okay, Christine Jacobs has a question from our webcast audience.

MS. JACOBS: Sure. This comes from Bill. He writes, "Jeremy Grantham made the following observation in his most recently newsletter. Widely taught concepts such as net present value or discounted cash flow all preach that a future dollar is worth much less than a dollar today. When applied to business decision-making, this principle directs us to short-term thinking, in effect telling us that if we have an orchard we are financially better off by cutting it down and selling the wood now rather than wait and hope for a future supply of apples. Given such powerful incentive, how can we reasonably expect business to have a long-term focus?"

MR. MITCHELL: Well, that's what I think I said, although I said it in financial terms. The orchard, the orchard metaphor, is actually quite beautiful, but that's exactly the question, right, is what are the incentives that prevent you from doing that?

Well, I mean, I guess one incentive, and this would be a little bit more aggressively regulatory than any of us have talked about, would be to force corporations to pay considerably more out in dividends than they do now, and by doing that, they would actually have to earn the money now in order to do it and shareholders would have to be content with those returns because you'd be necessarily diminishing the amount of

money stockholders can make from capital gains.

Also, that question presumes that, in fact -- and this is a theory that had a lot of currency in the '70s, '80s, '90s, and there are still fundamentalists who completely believe it -- that, in fact, the market does accurately discount down to present value. I think there are a number of us who have long disagreed with that and still do.

You're relying extraordinarily heavily on what we call an efficient market, which really, if you analyze it very closely, is a bunch of people's best guess about what this corporation's going to earn in the future. But if you're looking as far out as the capital gains we're talking about today would warrant it's impossible, absolutely impossible to think that you can, with any accuracy, predict that future, which turns capital gains trading into essentially gambling.

MR. WEST: Okay, right here we have a question.

SPEAKER: I'd like you to comment on --

MR. WEST: Could you give us your name and your organization?

MR. BRODSKY: I'm Marc Brodsky, retired physicist. Had a long career at IBM and American Institute of Physics, and I've watched innovation and investment innovation up close for many years.

One of the problems you haven't addressed is not only the compensation of the decision makers, it's an inherent property of the company's activities that long-term investment is such that it's hard to reap the rents, reap the benefits of the investment in an economy that's so communicative and internationally competitive now. And if I looked at the great American investments of Westinghouse, GE, IBM, AT&T, Bell Labs, Xerox, a bunch of others, they could have patient capital because no matter how long it took, these monopolies would reap the benefits.

Now an investment without a manufacturing base on which to transfer

the results of that innovation can't -- there's no way you can reap the benefits, and it's not just the company, it's the country too. We could educate everybody to be innovative, creative, great engineers, but the stuff that they invent and create is not going to be made here under the current circumstances.

That requires different kind of solutions than just compensation stuff. Could you comment on that, please?

MS. SAMUELSON: I think it's relevant, the question, the kind of financialization of the economy is the flip side of what you're talking about. I mean, there's a recent story out about what happened to Bell Labs, it's one example. One that I remember well is -- goes back to Merck's decision to invest in the drug that they had formulated for one purpose, found out it didn't actually serve that, thus had no commercial value, but was a cure for river blindness in the river delta of Africa.

So the then CEO, Roy Vagelos, had a decision to make. Was he going to bring this product to market where they weren't going to be able to make any money on it? And he did that extraordinary leadership moment where he did it. But he didn't do it out of altruism, he did it because it was still an era where he knew that if we didn't -- if his scientists, which was his scarce resource, that's what he was still managing for. If you wanted to be a successful company, he needed to have the best talent, and if he refused to bring a drug that had, in fact, a life-saving purpose to market and continue to make that investment, he would be undermining the beliefs and values and reason why those people came to work every day. And he proceeded to do that.

I think it would be much harder for him to do that 25 years later, but I think this is the essence of the problem, is, what are we actually valuing today? What is the purpose of the corporation? And how do we measure its success? And if it's only in financial terms we can't -- we cannot value those things appropriately that are in our long-

term interests.

MR. WEST: Okay. Right here on the aisle.

MR. CHECCO: Thank you very much. Larry Checco, Checco Communications. I guess I'd label myself a concerned citizen. And I think -- first of all, I want to thank you for a very rich conversation. This was terrific. But I have an underlying concern for this country, and it's the trust deficit that we have here. We don't trust the government, and I think the SEC was a total failure during this last collapse. Supreme Court with Citizens United, I don't think people trust them as much as they'd like to.

Our corporations have failed us miserably, especially in the financial industry. Nonprofits, even our religious institutions, have failed us miserably on some levels.

What do we do? Who do we turn to? To Judy's -- or, Ms. Samuelson's issue of leadership, how do we incentivize leaders to be altruistic leaders and not just self-serving leaders? How do we make them transformational rather than self-serving? It's a real dilemma. It's a real problem and I don't think --

MS. SAMUELSON: I don't think that's about incentives, but others --

MR. CHECCO: I don't mean financial incentives either, I mean moral incentives.

MS. SAMUELSON: I think it's about building communities and I think we have to look at what's happened to the trade associations of the business environment. I would take it back to the business sector.

MR. CHECCO: And I would -- I really appreciate that accent on community as well. I think that's what we're losing in this country, this sense of community. It's dog-eat-dog, winner-take-all, and until we get rid of that, we're in deep trouble. Thank you.

MR. WEST: There's a question in the very back on the aisle.

SPEAKER: The short-termism of institutional --

MR. WEST: Actually, can you give us your name and organization?

MR. EDWARDS: I'm sorry. Gary Edwards, cofounder and president of Ethos International. The question I wanted to put to you, it's a comment and a question, the institutional investors and their short-termism, I assume you include there private equity and hedge funds and not just pension funds and mutual funds, and having paid close attention to them in recent years, I've seen something that hasn't been mentioned by the panel that I think sets you in good stead for another set of allies.

The short-term orientation, particularly of private equity has led some multinational corporations, some U.S.-based global corporations, to put pressure from the board and from the CEO on the entire organization and of course it flows down hill. If you are an international marketing executive or if you're a country manager in a developing country, the kind of outcome that you often get is corruption. They're very good at hiding it now with the enforcement going on over at the Department of Justice increasingly good at hiding it, but it seems to be that you have a whole network of multilateral financial institutions and others who are fighting against corruption who also could be brought together with yourselves and likeminded folks to put pressure on the short-term orientation of our institutional investors.

MR. WEST: Okay. Right there on the aisle.

MR. MANHEIM: Frank Manheim, George Mason University. I think I was very impressed by the arguments and points that have been made by the panel. I congratulate you, but I think we've really underestimated the traumatic effect of the 1970s regulations, which we have to remember, took place after an environmental crisis and when the U.S. was riding high, an unsurpassed economic and technological power.

What they created then was an adversarial system directed against industry which was regarded as the chief threat to environment and if you're a bright young engineer and you suddenly face a 900 page law like the Clean Air Act -- not initially, but it became 900 pages -- and with close to 100,000 regulations, and language like compliance, violator, adjudicatory hearings, the old mystique of industry was gone and industry was now an enemy of society -- I'm exaggerating a bit.

So, what would be more logical for entrepreneurs to move from their former interest in product making to fields that were not or minimally affected by this panoply of laws with the costs and the legal and political risks that were involved? It seems to me inconceivable that you're going to get back to a moral climate when this barrier or this panoply of barriers unique in the world -- no advanced country has our labyrinthine legal framework, and I'm not talking about criticizing important regulation, but how it's done is really critical.

MR. WEST: On the aisle near the back --

MS. SAMUELSON: Quick comment. I think there's a whole world of soft law today that is equally powerful. I couldn't comment on -- I wouldn't comment -- I wouldn't take away from what you're saying about adversarial relationships and maybe not the best strategy for moving forward, although regulation has its role. But I think the whole -- today, a lot of the influence on corporations is actually not coming from the government, it's coming from well organized, you know, NGO communities of interest on whether it's human rights or it's on environmental standards or it's on something else.

So, it's a much more complex endeavor today, I think, for corporations to manage in this environment where they have government on the one hand expecting things, they're living in a global community where there may be a different expectation, there's different expectations about corruption all over the globe -- it's a very complex

environment and very dynamic.

SENATOR DORGAN: Let me just make -- you know, say a kind word about regulations, if I might. I think -- I don't want regulations to be over-burdening. I don't want them to be unbelievably complicated. I don't want federal agencies to behave inappropriately, as sometimes happens, but it's also the case that I'm enormously proud that our country created worker's rights and regulatory responsibility for worker's rights. I'm very proud that we said to companies who were spewing into the air shed things that were killing people, you can't do that anymore, you have to meet regulatory responsibility.

You know, I'm proud of a series of things that said if we've got people working in plants, there's a responsibility to provide a safe workplace for them. So, those are all regulatory things and when we take those requirements and go compete against countries in which they say, you know what, you can abuse workers, we don't give a damn what you pay them, you can sleep them 12 to a little tinderbox thing at night in these big factory operations, and you can work them 14 hours a day at age 12, and work them 7 days a week for 6 months in a row, and that's just fine -- well, it's very hard for us to compete against that. I understand that.

But that's not our fault because we did the right things and as we moved into this international economy -- this is what prompted me to write the book -- we're confronting all kinds of conditions that are unbelievable conditions in the way people are treated, and so on, that provide competitive advantages for other economies to prosper at our expense.

Our country has to have a little bit of a backbone and a spine to say to other countries, this is the most important market in the world for you, the United States marketplace. There's an admission price to this marketplace and part of that admission price is that you need to raise your standards up. We're not going to push our standards

down.

So, I don't mean to get on a soapbox about this, but I understand there's a lot of debate out there about unbelievable overregulation that's destroying America's economy. I want overregulation and absurd regulations gone, but I also want effective regulations adequately enforced in this country that make this a better place in which to live.

MR. MITCHELL: If I could underscore that for one quick second too. Let me ask you when the last time you tried to breath in Beijing was?

SENATOR DORGAN: Well, I was there a couple weeks ago and it's pretty hard to breathe in Beijing.

MR. MITCHELL: Right, let alone see the sunshine. But you do have a valid point and I think the Senator is right, I mean, I completely agree with what he said, but it's not -- the example you use of environmental regulation, you use the traumatic effect of the antagonistic way it was imposed.

If I can site just an example, one of the best known successes, one of the greatest regulatory successes in the United States, although it seems funny to say it now because it's kind of been a failure for at least a decade, has been the SEC. And the reason for that was that the SEC was created in a very antagonistic oppositional business environment in a way that integrated industry into constructing the regulations. So, when you ask where leadership comes from, leadership doesn't come from antagonism, it doesn't come from attacking, but if you regulate in a way that's cooperative where industry is involved, because we all want to breathe clean air, we all want to avoid child labor, we all want to have worker safety, then if you follow the model on which that agency was created, you probably get a much more palatable and equally effective set of regulations.

It's not -- I think your story is less about regulation than it is about the way it was pitched.

MR. WEST: Okay, back there on the aisle.

SPEAKER: Hello. My name is Aaron Trossis; I'm a student in economics at Johns Hopkins. I guess your comments about the difficulty that corporations have in raising this long-term capital struck me a little bit in contrast to some governments right now. You may have seen in the news that the UK government is considering issuing a 100-year gilt, so it seems that they're having a very easy time raising long-term capital.

So, I guess my question boils down to, do you think monetary policy has played any role in creating this kind of short term perspective in investing?

MR. MITCHELL: I want to say no, because this -- monetary policy has changed significantly over the past 30 to 60 years, but it's been at least 30 to 60 years since this short-term mentality was developed. I mean, had I the platform by myself and about three hours, I'd go through about 20 different sets of events that together caused the situation we're in now. I think we all agree, none of this is mono-causal, none of this developed over night.

I can take you back to the New York Stock Exchange in 1952 when it got a study done by this very institute showing how few Americans owned shares, and that's why they weren't making any money, so they went on a campaign to get more shares issued and more shareholders. There were lots and lots and lots of pieces of this.

Is monetary policy a part of it? Maybe. Maybe. But you'd have to look at it over the long term in coordination with all the other factors, so my answer would be, especially given the length of time this has taken to develop, no, it's not.

SENATOR DORGAN: Let me make a point that, in my judgment, the

Fed was an abysmal failure in the years leading up to the financial collapse a couple of years ago. I think Fed Chairman Greenspan admitted that in his book, although he wrote the book in a way to make it sound he was gold mining on the moon someplace when all this happened.

But I do think the responsibility of the Fed, for the oversight of investment banking, for the oversight of brokers, mortgage brokers, for the oversight of other enterprises that they had oversight responsibilities -- hedge funds -- we had a big debate in Congress about hedge fund regulation, but I think Fed Chairman Greenspan helped create a mentality in which the desire and the race for short-term gains became something that was very acceptable.

Had there been more effective oversight that the Congress gave the Fed the responsibility for with respect to hedge funds and some of the other areas I've mentioned, I think we would have had slightly less incentive for the short-term gain.

MR. WEST: I think we have time just for one more question right here on the aisle. There's a microphone coming up behind you.

SPEAKER: Thank you. This was a terrific program. I wanted to -- I was 15 years on the staff of the Senate Banking Committee, I was general counsel up there, and I saw the change from the stakeholder theory of corporate governance to the shareholder and I saw that what happened was it became the emphasis on shareholder value and then the CEOs tied their compensation to shareholder value.

And then I had another ten years on the U.S.-China Economic and Security Review Commission, where I saw China and other Asian countries, in particular, understanding how this worked, how to incentivize our corporation to increase shareholder value, and rewards for their CEOs by transferring our manufacturing and technology base from here to there.

And that's why you have so much innovation going on there and as the manufacturing goes, as the Senator pointed out, you have innovation going because you can't innovate if you're not making things, you can't innovate.

So, this is an enormous problem for us as we're facing this global economy and I salute you guys for thinking about this, but I think you have to look at it, and I think, Professor, you pointed out, this is a national security issue because when you're transferring this R&D and technology at such a rapid pace, it's an enormous problem for this country, and I think it's very important you're addressing it.

MR. WEST: Okay. I think we are out of time but I want to thank Senator Dorgan, Justice Jacobs, Judy Samuelson, and Lawrence Mitchell for sharing their thoughts with us and thank you very much for coming out.

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CERTIFICATE OF NOTARY PUBLIC

I, Carleton J. Anderson, III do hereby certify that the forgoing electronic file when originally transmitted was reduced to text at my direction; that said transcript is a true record of the proceedings therein referenced; that I am neither counsel for, related to, nor employed by any of the parties to the action in which these proceedings were taken; and, furthermore, that I am neither a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

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