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HEARING WRITTEN STATEMENT
"REMOVING BARRIERS TO JOB CREATION"
DEMOCRATIC POLICY COMMITTEE
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My colleagues have heard me speak in recent weeks about troubling trends in our financial markets – the growing use of dark pools and high-frequency trading, increasing market fragmentation and looming regulatory gaps at the Securities and Exchange Commission.

Today I want to talk about an economic threat that encompasses these developments and why I think they are negatively impacting the long-term health of our economy. After suffering through the most severe recession in decades, we are now in the midst of the most fragile of recoveries.

It is evident to all that we are in a jobs crisis. We need a laser-like focus on innovation policies that encourage industry to create jobs. But this challenge comes not just from the financial crisis and the recession that followed. The American economy has slowed in its efforts to create jobs for the past decade.

According to the Bureau of Labor Statistics, the United States had 108.5 million private, nongovernment jobs as of September 2009. But while our population has grown nine percent in the past nine years, the number of jobs now available is essentially the same as in June of 1999.

Many of the jobs this economy did create in the past decade were in the financial, housing and consumer-led retail sectors. And two of those — financial and housing — were bubbles that have now burst. Without these sectors playing a key role in providing new jobs, many Americans are asking: where will future job creation most likely occur?

In the past, job creation would often come from the raft of small, newly-financed, often innovative companies which raised their capital with the help of Wall Street underwriters. Now, I am deeply concerned that there is a choke point in our efforts to return to economic vibrancy, a choke point that can be found on Wall Street.

Our capital markets, which have long been the envy of the world, are no longer performing one of their most essential functions: the constant and reliable channeling of capital through the public sale of company stock — known as an Initial Public Offering — which small companies use to innovate, and most importantly, to create jobs.

There is an IPO crisis in this country, indeed, according to a report released last month by the accounting firm Grant Thornton, the IPO market in the United States "has practically disappeared."

That, in turn, according to a second Grant Thornton study, has had a ripple effect on the U.S. stock markets, with the number of stock listings since 1991 dropping 22 percent in absolute terms and 53 percent when factoring in inflation-adjusted GDP growth.

New companies have been shed from the NASDAQ, New York and American Stock Exchanges faster than they have been created; from almost 7,000 publicly listed companies in 1991 and nearly 8,900 in 1997 during the dot-com bubble, to 5,400 listed in 2008, a turn of events Grant Thornton has dubbed the "Great Depression of Listings."

The United States is practically the only market in the world where this phenomenon is occurring: the major stock exchanges in Hong Kong, London, Milan, Tokyo, Toronto, Sydney and Frankfurt, have all grown from their 1997 levels, Grant Thornton reports.

The effects of this IPO crisis have rippled throughout the U.S. economy. Because 92 percent of job growth occurs after a company goes public, job creation may have been stunted by these developments. In fact, according to the Grant Thornton study, if the IPO market was working properly today, we would have as many as 10 million to 20 million additional high-quality jobs for middle-class Americans. Even if that estimate is off by a factor of ten, this failure of Wall Street to provide capital to small companies may be costing our economy millions of foregone jobs.

Most every large company begins as a small company. And the IPO market has been hit hardest at the smallest end of the market. The median IPO in the first six months of 2009 was $135 million. Twenty years ago, IPOs of $10 million were routine, and routinely succeeded.

Furthermore, we cannot forget the critical role venture capital and long-term investment have played in growing our economy and creating jobs in a variety of sectors. Indeed, 17 venture-backed companies, who raised a total of $367 million in capital and, today, provide 470,000 US jobs, are among our economy’s biggest success stories.

The vast majority of these companies, which include Intel, Yahoo, Oracle and Dell, would not have been able to go public today due to the prohibitive costs of raising public equity capital.

What has happened? A host of well-intentioned changes, some technological, some regulatory — with many unintended consequences.

Online brokerage firms, with their $25 trades, first appeared in 1996, hastening the decline of the traditional, full-service brokerage firms — who charged $250 per trade.

Those hefty fees, however, helped maintain an underwriting apparatus that encouraged small companies to go public, and supported a substantial research base that attracted both institutional and retail clients.

The rich ecosystem of investment firms, including the Four Horsemen — Robertson Stephens, Alex Brown & Sons, Hambrecht & Quist, and Montgomery Securities — that helped their institutional buy-side clients take part in IPOs and marketed follow-on offerings, no longer exists today.

Structural changes in the U.S. capital markets dealt the final coup de grace. There were new order handling rules; decimalization, which shrank spreads significantly and made it increasingly difficult for traditional retail brokers to remain profitable; Regulations ATS and NMS which vastly expanded the electronic marketplace.

Finally, there has been the explosive growth in high frequency trading, which takes advantage of the market's now highly-automated format to send a thousand trades a second ricocheting from computer to computer.

The result, as *The Economist* magazine wrote last week, is that the "'high-frequency' traders who have come to dominate stock markets with their computer-driven strategies pay less attention to small firms, preferring to jump in and out of larger, more liquid shares.

“Institutional investors," *The Economist* continues, "wary of being stuck in an illiquid part of the market, are increasingly following them."

This is a situation that stands as a wall against a sustained economic recovery. One of the very vital tasks before Congress is to help unemployed Americans by crafting innovation policies that will rebuild our economy, catalyze growth and create high-quality jobs for struggling Americans.

We must identify the causes of last year’s debacle and apply them to our current economic challenges in order to help the millions of struggling Americans and avert a future disaster. The notion that Wall Street has resumed its risky, and as we know all too well, disastrous behavior is simply inexcusable.

In order to reverse this ominous trend and help companies to raise capital to innovate, create jobs and grow, we must restore the financial sector's historical role as a facilitator of long-term growth, and not the source of one bubble after another.

The question, finally, is this: How can we create a market structure that works for a $25 million IPO — both in the offering and the secondary aftermarket. If we can answer that question, this country will be back in business.