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Just one week ago at an American Assembly, I spent three days with 29 Economists, mostly professors, and 23 corporate officers, mostly vice presidents of finance, and a half dozen financial writers at a fine setting in upper New York, to discuss capital formation.

I was impressed by a number of things, not the least of which was the professional treatment given to a myriad of government policies that effect the ebb and flow of capital. There were differing views: Conflicting definitions of the issues, conflicting theories, conflicting predictions, and conflicting data. Nonetheless, the group was able to agree upon a broad policy statement. We said:

> Tax policies result in ineffeciencies in the allocation of capital. Regulation that distorts prices curtails investment. Inflexibilities imposed by law in financial markets cause misallocations of saving.
>
> "We must design our regulatory policies, tax system, and financial market policies in ways that reduce impediments to investment."

Simple enough I suppose, but on my return from the meeting, I was prompted to wonder -- if so diverse a group can so clearly see and describe the path to real economic growth -- why is it that our leaders in government and in business cannot put us on that path?

Why have we not made these changes?

The answer, as I see it, is that we suffer from a broad failure of leadership. A failure not related to a President or a Congress, or the regulatory agencies -- but rather, a persistent, pervasive failure over a number of years by all of us in government and in business to give the American Public a vision of what our economic system means to our political system, and to consistently act in accordance with that vision.

Far too many -- I include myself -- pay only Lip service to the notion of free enterprise. We content ourselves but confuse the public with shop-worn slogans: Free Enterprise, Balanced Budgets, No Deficit Spending, Deregulation and Capitalism.

Surely we have used them for enough years, to know that they are not stirring the hopes or the votes of the of the American Public.

The sad fact that is that the American people have lost interest in the free enterprise competitive system that we call capitalism.

They lost interest because they do not believe it is free, they do not see the commitment to competition, and a "Capitalist" sounds too much to them like another one of those fellows who will not tell the truth.

I suggest that a new philosophy for free enterprise is needed: One for which government and business will provide consistant support -- a philosophy centered on the theme, that a sufficient degree of economic freedom is essential to our political freedom.

Frankly, I see little chance that we will be able to affect the changes in regulatory and tax policies that are so critically needed, unless the public does accept such a philosophy, and I similarly see very little chance such public acceptance.

-- Unless the Business Community can convince itself and the public that free market competition is a far better regulator than government and

-- unless the public is assured that the business community will act responsibily if freed from some existing regulation.

From a perspective of two years in government, I see us in a somewhat precarious balance: Either we will make progress toward freer market competition or there will be an almost inexorable trend toward even heavier regulation.

Let me speak this evening on these two points:

-- Faith in competition, and

-- Faith in the capacity of business for self-discipline.

I need not remind this audience that it is easy to be cynical about whether business generally has a real commitment to competitive markets. It should also be clear to us all that the public disinterest in free enterprise comes from this apparent disinterest of much of the business community in the free market system.

There are far too many examples such as the transportation and communication industry which have for so long been reluctant to be exposed to full competitive pressures.

We also know far too well that the absence of competition brings more government regulation -- regulation that can stifle profit on the one hand or regulation that can preserve levels of profits so high on the other hand that businesses are tempted to evade regulation with kickbacks or other economic concessions.

We saw the latter in the securities industry when fixed commission rates brought give-ups and reciprocal payments to large institutional investors.

We see it in the sale of alcoholic beverages when selling prices are fixed by states. Illegal payments made to get the business of good customers are being discovered all to frequently.

we see it now tragically in the shipping industry where millions of dollars of illegal kickbacks and rebates apparently have been used to get business from shippers that wanted lower rates than fixed rates provided. Did you notice that for a period this year Russia was cutting prices on its Atlantic Ocean trade?

There must be some special place in the free enterprise hall of fame for the people that created a system which caused the Russians to stop this price competition and to join the Western world's rate fixing bureaus.

It is axiomatic that oppostion to government regulation increases in direct proportion to the distance one's own economic interest lies from such regulation.

The small businessman who suffers, more than any, at the hands of government bureaucracy and the paperwork it spawns, is vocal in his support for deregulation, but he is far more effective when he opposes a repeal of the Robinson-Patman Act.

Even the consumer advocates who demand deregulation of prices for air, rail, sea, and truck transportation seek at the same time a new federal chartering of all large corporations that would subject business to a far greater degree of regulation.

I can't say it any better than did the Chairman of General Motors a few weeks ago:

> "If you want to be allowed to compete
> you must be willing to compete."

The government, of course, is capable of restricting competition entirely on its own. We need look only to our growing funds -- Pension, Trusts, and Mutual -- that are at the heart of capitalism.

Government regulation is gradually isolating these investment dollars from competitive forces. Some laws are widely interpreted as forbidding investment in some kinds of equity securities and other regulations such as those of the SEC actually prohibit funds from advertising their own past performance.

The mere fact that three separate government agencies regulate the three different kinds of funds make it apparent that regulation is destructive of a true competitive environment.

But suppose we could convince everyone, including ourselves, that competition is the better regulator. Can we convince the public that our system of corporate governance is acceptable. Or, will we as a nation insist on far more rigid federal controls on corporate decision-making.

Criticism about corporate governance has been crystalized in Ralph Nader's new book. He there speaks of a corporate arrogance that he says pollutes, bribes and fixes prices at will, and then spends billions of dollars in advertising the virtues of its activities.

To control these alleged aggressions, the Nader book proposes federal chartering that would put major corporations under firm federal control and place public interest and employee representatives on their boards.

From my perspective -- the manner in which business and government responds to such charges and such proposals can have a profound impact on the structure of our society.

Arguments for and against these proposals have too often missed the point. Debators argue over whether the nature of corporate abuses have been exaggerated.

A far more constructive effort would be a candid evaluation of how our corporations are now governed, one that admits shortcomings and proposes alterrations tailored to correct those shortcomings.

Such a debate would deal with three separate issues:

Corporate behavior that is contrary to law,

corporate behavior that is contrary to good business practices, and

corporate behavior that is contrary to someone's notion of good public policy.

So stated we should ask, with respect to each, would federal chartering work better?

First, would it provide more effective law enforcement? If you say, yes, you will be ignoring one of the most successful law enforcement efforts in our history, an effort still underway at the SEC to uncover questionable corporate payments. Twenty-two successfully concluded federal court actions, and over 200 corporations that have displayed past payments, is success by any standard.

Why is it then, that so many who are quite removed from the firing line so easily propose sweeping changes in the law? Do they really want to scrap a system of corporate self-governance, enforced by the SEC over 40 years, at the very time in its history that it has functioned at its best?

Or, will the Public, Congress, and Business, accept our view that the proper course now is to institute tighter internal audit standards, place more responsibility on outside auditors and encourage the placement of truly independent individuals on the boards of directors. Directors that would still be representatives of stockholders rather than of a public interest sector.

Not a glamorous solution, not one that will bring headlines to its sponsor but one that would very likely work.

Second, would federal chartering cause our corporations to be managed better?

Well, I don't think so, but let's see if we can agree on what's wrong with managemnt now.

-- Too many boards are dominated by inside directors. Outside directors are too often so close to the President that they would rather resign than severely criticize him.

-- Compensation for directors is often set at a figure so low that no real work is expected.

-- Information provided boards in too many cases is the product of management; outside directors feel no responsibility to make independent inquiry.

-- Inside directors control the vote too often on salaries, on merger proposals, tender offers, on management succession and the filling of board vacancies -- all subjects where the stockholders interest may be different than that of management.

-- Thus, many companies limp along under poor management until economic setbacks are so severe that a large perceptive investor bids for stock control recognizing that the corporate assets can produce better profits.

Stockholder democracy in many cases therefore means nothing more than the right to sell stock.

What is missing on too many boards -- in short -- is a truly independent character that has the practical capacity to monitor and to change management.

But that which is missing on some boards is present on others. We do have splendidly performing companies that have effective, responsive and responsible boards of directors.

As we look for remedies therefore -- it is far more sensible to encourage the poorly performing boards to emulate the model of the successful companies, than it is to experiment with a system that has worked nowhere. Look to Xerox, General Motors, Connecticut General, Texas Instruments for examples of independent boards, rather than to the quasi-governmental type corporations being spawned abroad.

The essential first step is the creation of a panel of outside directors that will have the practical ability and the perceived need to secure information about corporate operations.

Such directors should be paid more, spend more time on corporate business, and have jurisdiction to approve or veto decisions on those issues where the self-interests of managmenet puts them at potential odds with the best interests of stockholders.

These are the enduring truths that govern more and more corporations each year, and these are the considerations that caused the New York Stock Exchange, just last Thursday, to proclaim that it will change listing requirements to require independent audit committees.

We can reasonably conclude a better system of management is well under way.

A process of change not dictated by government -- but propelled by good economics, by the self-interest companies should have in attracting investor attention.

In contrast, can anyone seriously argue that federally chartered boards with public interest directors will create better-managed companies?

Who among you really would trust your investment dollars to directors who have an ill-defined obligation to an ambiguous public policy?

That leaves only the third part of the analysis. Do we want our corporations to be instrumentalities that will carry out public policies that are not set forth as statutory mandates?

It is tempting to put public interest directors on a board, to speak for employees, for environment, for a better life.

Sure, it is difficult for Congress to balance between needed economic growth and environmental improvement -- between the need for profits and the desire for safe products and working conditions.

Why not put the hassle on the boards and make them get board members who have this broader public interest at heart?

The answer is that it will not work. Raymond Vernon pointed out that in Europe there

> "Has been a growing tendency to use large national enterprises as if they were agencies of the state. And there has been a related tendency to develop methods of government that have reduced the role of the parliamentary process and elevated the role of specialized groups."

In sum, when governments have tried to use corporations as instruments of government policy, the corporations become less efficient and the government becomes less democratic.

I dwell on corporate governance because our business community is the nexus of capitalism. If there is no faith in it; if it does not function <u>effectively</u>; if it is not perceived by the public as so functioning; and if the laws we pass with respect to that business community are not carefully targeted upon real problems, our free market system can erode into one that is non-competitive, less innovative, more concentrated, quasi-governmental, and less efficient.

Thus, we need to encourage responsible criticism. We need more who agree with the President of the Bank of America who said:

> "Our integrity is the foundation for the very basis of our ability to do business; <u>if</u> the market economy ever goes under, our favorite villians -- socialist economists and government regulators -- won't be to blame, we will."

More who appreciate the candid observations of the Chairman of General Motors:

> "The business community really has done next to nothing to persuade the public . . . that the marketplace rather than the government is almost always a better regulator . . . .
>
> ". . . We are not consistent in what we say. Business too often rails against government regulations -- except those used to bail out particular companies . . ."

We need more who will seek effective changes in corporate governance as has the current chairman of the board of the New York Stock Exchange who is now fulfilling that organization's 35 year old goal of creating independent audit committees.

I mentioned earlier the call of an American assembly group for a redesign of our regulatory, tax and financial market policies in a way that will reduce existing impediments to investment.

With a strong, candid, and consistent commitment to competition and responsible corporate governance there will be many in government to help clear the way.

Let me cite five intergovernmental initiatives which have just commenced at the Commission.

We are seeking:

-- To eliminate the Tax discrimination against equity in favor of debt. By allowing interest on corporate debt to be deducted and not dividends paid on securities, our laws have unintentionally contributed to the grave imbalance that now exists between debt and equity. Whether that should be accomplished by allowing dividends to be deducted, or by integrating corporate profits into the personal income of shareholders, it is a matter that must be resolved;

-- Second, we seek to eliminate taxes Levied on corporate profits that are not real in an economic sense by reason of inflation;

-- third, we seek to put all investment funds, whether under the jurisdiction of ERISA, Bank Regulatory Agencies or the SEC on the same regulatory standard -- to eliminate all artificial barriers which prevent certain kinds of investment from having access to these funds, and to permit full advertising of investment results;

-- fourth, we shall attempt to entirely redesign our regulation of venture capital efforts; and

-- finally, we have just begun to reconsider existing rules that by May of 1978 will prohibit members of exchanges from doing both a money management business and a brokerage business for the same accounts. With the whole industry becoming far more competitive, there are serious questions as to whether this restriction should be changed. Obviously, we must move fast because many firms either have already or are in the process of eliminating their money management business.

We have met or will meet with representatives of Congress, the Federal Reserve Board and the Treasury Department before the end of the year to coordinate our efforts for 1977.

These efforts may seem modest, but they mean that the Commission now recognizes that it has the same kind of responsibility to work for removal of impediments to capital formation that it has long had to police abuses that occur in the process of capital formation.

More important, agencies and departments throughtout government can add substantially to our list if the climate for change can be created and maintained.

I spoke initially of a failure of leadership but that does not mean an absence of leadership. President Ford has given full support for responsible regulatory reform and the President-elect seems to be committed to the same course of action.

The points of my remarks this evening is that reform can either strengthen or weaken a free market economy. We cannot have a new philosophy for free enterprise unless we are universally and consistently committed to the proposition that fair competition is a better regulator than government.