Seidman

February 5, 1975

MEMORANDUM

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To: Milton Friedman
White House Staff

From: Andrew P. Steffan, Director APS
Office of Policy Planning
Securities and Exchange Commission

Re: The President's Speech to the
New York Society of Security Analysts

(1) AR5050
(2) Utilities
(3)

Attached is a short draft along the lines we have discussed. You will note we have included: (1) language supporting the securities legislation, which we understand to be the Administration's position - Edward Schmults, Under Secretary of the Treasury, has probably been most involved in developing the Administration's position on this; (2) reference to the proposal that dividends be deductible for tax purposes when paid on newly created preferred stock, which I believe is part of the new economic program; and (3) reference to the Office of Capital Markets Policy in Treasury set up under Assistant Secretary Gerald L. Parsky.

Chairman Garrett has reviewed this. I am enclosing three recent speeches in which he covers the new securities legislation (and regulatory steps), the capital raising problem and the health of the securities industry in greater detail than I believe you wanted in this draft.

It is our view that if the Administration plans to discuss proposals that the government provide equity capital to companies with serious liquidity problems, this would be a good audience.

We are anxious to provide further help. However, the Chairman will be out of town Thursday afternoon and Friday and I will be out the rest of the week, but can be reached by telephone. I will be back Friday night and you can reach me at home (965-5178) or at the office (755-0222) from Saturday on.

In our absence this week, I suggest you call Kathryn McGrath (755-1130).

cc: Chairman Ray Garrett, Jr.
Harvey L. Pitt
Theodore C. Barreaux
Kathryn B. McGrath

In addressing audiences composed of members of the Wall Street community, many speakers are fond of pointing out that the U.S. capital markets are the envy of the world financial community. Certainly, I have always been impressed with the ability of our markets to raise large amounts of capital for government and private industry and to satisfy the constantly changing requirements of a broad range of investors. The strength of our markets results, in large measure, from the vitality of the U.S. economy. However, it also reflects the dynamic character of those who make the markets work - the brokers, investment bankers, fiduciaries and "institutional" investors, and the security analysts.

It is your imagination and ingenuity which has enabled our markets to respond to changing economic conditions and to new demands by governments, corporations and investors. The health of our economy, therefore, is not only a cause but also a result of the strength of our capital market system. In the last decade alone, over $700 billion of new capital has been raised through new security issues.

To accomplish this, you have had to cope with significant changes in the requirements of those seeking to raise capital as well as in the attitudes of investors. In spite of the experience of this audience in predicting the future, I doubt whether many of you would have predicted fifteen years ago the rapidity of the build-up in funds for investment in the hands of fiduciaries, or the direction this investment would take. Clearly, the system has been strained from time to time by such developments, causing, for example, tremendous volatility in equity trading; but the market system and those who make it work have bounced back time and again.

Now the system is once again being disrupted. To a large degree, of course, problems being experienced by the financial community today result from the dramatic decline in the average price of equity shares during the last several years and the corresponding decline in revenues and profits for many. The source of the present difficulties is at least partly the serious economic problems which the country faces, including inflation, the dramatic rise in the cost of energy, high interest rates and, most recently, the fear of recession.

I am heartened, needless to say, by the recent show of optimism in the securities markets and hope that this reflects confidence on the part of investors that our program to come to grips with the economic problems facing the country will have the longer term positive benefits which we expect. However, as you know, I do not expect we will resolve our problems overnight. Furthermore, it seems likely that the demands on the capital markets of the next decade may be substantially different from those you have been dealing with in the past ten-to-fifteen years.

There will be an even greater requirement for new capital, I understand, to meet the challenge for energy independence and to provide new sources of energy. This will occur at a time when the government will be calling on the capital markets to finance the proposed deficit in spending so critical to our plan for economic recovery and when many corporations will be seeking equity capital in the markets to reduce balance sheet leverage and to replace the cash flow lost to inflation. Further complicating the problem, investors may be cautious about purchasing equities after experiencing the dramatic decline in equity values of recent years.

Nevertheless, I have confidence that the financial community will rise to the challenge once again. I recognize that the securities industry has been dealt a serious blow by the events of the past few years - that, for example, revenues are off 25% for New York Stock Exchange member firms in/the past two years and that the number of securities firms and the number of professionals in the business has also declined sharply.

In spite of this shock, or perhaps because of it, the securities industry may be leaner and stronger today than during the period of buoyant stock prices. The new financial community that evolves from this difficult period will be more balanced, more flexible, more efficient and better able to meet new demands for capital and promising investments.

To that end, the Administration supported last year and will support this year the new legislation providing for important changes to the structure of our markets. I know this audience is well aware of the provisions of the various bills and that many members of the financial community have assisted in their development. The national, or central, market system which is the major focus of this legislation should insure the evolvement of a healthier, more efficient securities industry to meet the challenges of the future.

In recognition of the difficulty many companies face in raising needed equity capital, my economic program provides that corporations be permitted to issue a new type of preferred stock, the dividends on which would be deductible for income tax purposes. This proposal is intended to eliminate the tax advantage to issuing debt as opposed to equity.

I am aware that professional investors and security analysts have become increasingly concerned about the risks associated with balance sheet leverage, in spite of the benefits to earnings growth. Your increased attention to the basic financial strength of corporations seems certain to contribute to the ability of our markets to meet the challenge.

The Administration's concern with the health of the capital markets has also led to the establishment of a small, but important, office in the Treasury to coordinate with those organizations such as the S.E.C. and the Federal Reserve Board, which are dealing directly with capital market problems. We hope this effort will improve the government's planning for and reaction to important problems.

However, in the final analysis, it is the financial community itself which must provide the leadership. The intent of the pending legislation and other programs is to provide the most efficient and open system - to enable it to respond most effectively. I am confident you will meet the challenge.