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YOUR ROLE IN THE FUTURE OF AMERICA

An Address by Chairman Harold M. Williams
Securities and Exchange Commission

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I suspect you would all rather dance than listen to me talk about the national market system. It may be of interest to a number of the men in the audience; however, I am not sure how many of the wives really care about whether the ITS links or not. I am going to save some of my comments on the national market system until the morning when I look forward to the opportunity to have an interchange with you all.

With that in mind, while I will talk some about the national market system tonight, I would like to talk about a somewhat broader subject that should be of interest to you all.

To begin with, I think you deserve an awful lot of credit and appreciation from the country as a whole for the performance of this past week. All the votes are not in and we do not know if anybody is in trouble. The last we heard at least the place was not burning down. Between the exchanges and the over-the-counter markets, you traded something on the order of 400 million shares last week. In a chaotic market -- a market which, as you know, is at least as much psychological as it is economic -- with an overlay of all the articles that we have read in the last month about how we are heading for another '29, which makes everybody a little up tight -- the performance was really outstanding. When you look at why, again, I think there is a lot that is encouraging about it. Whether it is the tape, or whether it is NASDAQ, or whatever, information flow -- the ability to know what is going on -- is much superior to anything we would have experienced a decade, or even half a decade ago. And even if the tape was running late, it did not make a difference because the information was there. When you are in a troublesome market, you know better than I, the importance of knowing where the market is and the confidence it gives you in terms of your ability to know how to position yourselves or what your response ought to be.

It also tells us something else. It tells us that 80 million-share days are not a figment of the imagination. About two and one-half years ago a friend of mine in New York threw a dinner for me when I was coming back to be Chairman. I sat across the table from the head of one of the major firms on the Street and we were speculating about what volume to worry about. And he thought that the most we had to worry about was a 50 million-share day. The New York Stock Exchange talked recently about the prospect of a 100 million-share day. I suggest to you that we have to worry about 150 million-share days at this point -- that is on the

New York Stock Exchange with all of the rest of the volume that will be involved in all the other exchanges and over-the-counter. Regardless of anything called the national market system, there are many things we must do in order to maintain the flow of information, in order to expedite trading, expedite clearing and settlement, and all of the other activity that goes on around the markets. We have got to expedite them. We have got to automate them as best we can in order to be sure that we can survive and thrive, and that the markets can continue to function the way they must if our capital markets -- which are the basis of this economic system of ours -- are to continue to be active, effective and trusted by you all and by the American people.

Perhaps the most significant testimony of how to prepare for the '80s is the fact that tomorrow's session is canceled. I can visualize Al Shoemaker writing his comments while INA is negiotating with Paine Webber. It tells you very dynamically, very graphically, how you prepare for the '80s. You prepare for uncertainty and you prepare to survive and to thrive on your own wits, on your own good management, good judgment and your ability to take risks successfully.

The late Charlie O'Hay expected the market to take off in this quarter and, as you may have read, that there would be a bull market for the next two years rising 1400 at that point. He could be right. Meanwhile, one of the most interesting comments he made was that he expected a lot of 80 million-share days in 1980, and I think he is probably right.

And whether the market goes to 1400 or not -- or goes sideways -- or whether equity markets are really the place to put your money or the place where individual investors put their money or not, the volume is there and growing. Everybody tells us equities are dead. Business Week devoted an entire issue to it. They may be dead, but we have 400 million shares to talk about this week that say that they ain't quite dead, and we have got to be prepared for them to be alive and kicking -- and kicking even harder than they are right now.

I think the conditions of the '80s that we have to concern ourselves with boil down to the question of what is the condition of the economy likely to be? While I just said that, in a way, equity markets may be active independently of the direction of the economy or the direction of the markets themselves, I think that if the economy is healthy, and on a course that people trust and have confidence in, and the people are positive about the future of

America, then you do not get the kind of volatility and uncertainty that characterized the week we have just had. If we are going to have a healthy economy, we have some very real problems to address -- problems this country has been talking about for a long time and doing absolutely nothing about.

The two basic problems are inflation and energy. The inflation problem is probably the most significant and you cannot lay it off entirely -- or even primarily -- on energy itself. When you look at inflation and at its impact on corporate profitability you find that there is probably nothing quite as inaccurate or unenlightening as the way corporate earnings are reported today, absent any indication of the impact of inflation.

Corporate earnings reports mislead us into believing that corporate profits are at an all-time high, and, indeed, individual companies take pleasure, and understandably so, in pointing out that theirs is at an all-time high. But, they are unadjusted for inflation. They are unadjusted for the impact of the replacement cost of the equipment of those corporations which is being utilized in order to produce the goods. They are unadjusted for the fact that the effective tax rate of inflation-adjusted profits is probably 55 or 56 percent as contrasted with the 43 percent we talk about. They are unadjusted for the fact that while corporate dividends are, on an unadjusted income basis, somewhere around 35 percent, which is a comfortable percentage, in reality, corporate dividends are running at 60, 70 and 80 percent of income adjusted for inflation and after taxes. The reality is that corporate America today is not retaining enough profit after taxes and after dividends to replace its capital, to replace the plant, to improve productivity, to provide for the expansion that we need, and to create the jobs on which this country depends. And, if we recognize the corporate system as the underpinnings of the economy of this country, we have to be concerned that those underpinnings are being eroded, and that there are corporate managements and boards of directors in this country that are, unconsciously or otherwise, in the process of liquidating their companies.

I am pleased that the Financial Accounting Standards Board has finally moved in a direction that I think will begin to enlighten shareholders and others about the impact of inflation on corporate America. In some ways more important than enlightening shareholders, is that we need to enlighten public opinion. We need to enlighten those in Washington who make tax policy and economic policy, who look at corporate earnings and at times will call them excessive or obscene, and who then judge to what extent corporate earnings can be transferred to serve other social purposes of the country, and to cause a reassessment of how much you can take out of the system without replenishing it.

We also know that inflation erodes savings of individuals and erodes retirement income. More importantly, it erodes confidence in the future. It causes people to buy illiquid tangibles because, for some reason, when people are unsure of themselves they think they can do better with something they can put their arms around. But wait until they try to sell them.

Perhaps more importantly, without a growth in national income, we cannot begin to address the social needs and social aspirations of this country. Over time -- and the history of the world and the history of prior inflation tell us this -- it is inflation that brings countries and political systems down. Inflation brought Germany down in the '20s despite some of the most enlightened and intelligent economists that the world has ever know. And why? Because, primarily, they were unable to face the political consequences of trying to get inflation under control.

This is not a problem that we lay alone at the doorstep of The President of the United States. It is not a problem that Paul Volcker can solve -- but I think he is doing a magnificent job at trying. It is a problem that you and I have to solve. And it is a problem in which all of us, <u>all of us</u>, are going to have to pay part of the price. It is a problem in which, whether as individuals or as groups in this society, we are going to have to stop looking out for our <u>own</u> personal interests and start thinking about what is good for this <u>country</u>, and start thinking about the priorities <u>of</u> this country. And whether it is business that talks about free enterprise and then comes to Washington and lobbies for special legislation, or whether it is labor which is concerned about unemployment and lobbies for trade barriers to protect employment, or whether it is the farmers who come to lobby for subsidies, or whether it is any of the various social groups who lobby for assistance to their special interests -- they are all special interests.

And in many ways, you represent special interests in whatever your primary interests are. If we are going to address inflation and get it under control, then the people who make the legislation in Washington are going to have to know that that is what you want. They are not going to provide the leadership. They are going to respond to your message as they perceive it. That is what being a representative is all about. Your representative is going to behave the way he thinks will cause his constituency will re-elect him. And he may say things that differ from the way he votes, so you hae to look at both.

But the message has got to come from the American people, and the belt-tightening and responsibility has to come from the American people. This problem will not be solved by Washington. You can talk all you want about a balanced budget. You can talk all you want about cutting federal spending. The only way that spending is going to be cut is if you insist that it be cut, and if you are prepared to have it cut where it hurts you -- not someone else.

Now that same point can be made just as well about energy. The embargo was in 1973. The message was clear. President Nixon made his Energy Independence speech in '73. But we paid the price of Watergate. The President made that speech on the radio on Saturday morning opposite "Howdy Doody" on television, and that tells the story.

We are now six years later -- almost exactly six years since the embargo began. Our position economically in the world, our position politically in the world, have been seriously undermined in the meantime. But we are no closer to having an energy policy now than we were six years ago.

And, why? Because we are fiddling. Nobody wants to pay the piper. If you want to watch the economic and political independence of this country go down the drain, just sit by and watch because it is going to happen unless we get going on that front as well. It has got to be painful. And again, it is difficult for the politicians to call for pain when they cannot stroke you at the same time. The good feelings will come later, perhaps during somebody else's administration, and that is a tough one for a politician to put over. We just cannot get from here to there without a real sense of involvement on the part of all of us.

There is another area that ties into that as well, and that is more generally, as I have said, you cannot count on the federal government to solve those kinds of problems for you. They can provide a certain kind of leadership, a certain kind of sense of direction once they know it is what you want. But increasingly, whether it is for social purposes or otherwise, we have moved towards the view that it is the federal government that should prevent and cure everything that goes wrong in this country and every kind of pain that exists. And for every kind of pain or inequity there must be a federal remedy. The tendency, then, on the part of many in the private sector in whatever field, is to sit back and wait for the federal government to design and implement that remedy.

A pattern now exists in the federal government. It is one of continuing efforts on the part of the federal government to pass laws to remedy some perceived wrong or some perceived malfunction in the system. And sometimes the remedy is a hell of lot worse than the disease or the perceived disease.

We have seen that in a lot of areas. You have heard, read or experienced, the impact of legislation like occupational health and safety, and some of the problems that have been generated by that. I suspect that some of you have experienced the distortions created by ERISA -- by the new Retirement Systems Act.

And I suspect that some of you have experienced what you might consider to be distortions -- or whatever -- from something called the national market system, as well. I expect you may see, hear and feel more of those as time goes on. While on the one hand, much of the focus of the national market system activity to date has been in the exchange arena, you are all going to be a part of the national market system, to one degree or another or in one way or another. It is coming closer every day. I think some of the proposed rules that are out -- like 19c-3 on off-board trading of newly-listed securities, qualified securities and a few other things -- all begin to engage you with the dialogue on what a national market system will be like.

My own sense is that we are making very good and very responsible progress towards the national market system. Congress told the Commission to facilitate the development of a national market system. It set forth certain criteria for what that system ought to be like, some of which are not necessarily and totally compatible with some others. They were very general in terms of how to get from here to there, and left the judgment, essentially, to the Commission and to the industry. The industry, in many ways, not being monolithic and having different interests, is finding it somewhat difficult to get together on what a national market system should look like, and very understandably. But the important point is that the Commission's role is one of facilitator. We are not systems designers and we are not here to finance the national market system either.

Beyond that, there are, clearly, opportunities to improve on the system, and indeed it needs to be improved as I have said earlier, if we are to be able to cope with the kinds of markets that we see emerging and are to be able to maintain the primacy -- or the unique and singular nature in the world -- of our American securities markets, and to be able to serve the needs of the American and the world economy. They have to be improved. So, the interests of you and of the Commission are, at least, in those ways, very synonymous.

Beyond that, the system ain't broke, and therefore the process of improvement is one that should be evolutionary and should come, over time. It should come with all deliberate speed. It is not something that you or we have any right, under the law, to sit on our hands about. It means that we have got to move it along. It means that we have got to take the sensible steps that are in keeping with the implementation of the 1975 Act, and it means that we have to push for the development of the kinds of facilities and all that will make for a national market system.

Now, we articulated, in principle, what those were in 1978, and continued a dialogue with the industry that has caused a shift in priorities, or a shift in some of the dimensions -- at least for now. But we are moving along with it, and the speed, while not satisfying to all, either within the Commission, in Congress or in the industry, is, in my judgment, an appropriate, considerate and responsible speed with which to move.

What we do find, and expectedly so, is that some of the things we do, do not necessarily work quite the way we expected they would. I learned long ago that if the unexpected can happen, it will -- and it usually does. Human beings are the most difficult things to anticipate. They are the most illogical creatures in the world, and what you expect they will do, often does not happen. The unexpected and the perverse is often the product of people acting in their own self-interest or in their own way.

What we do find is that as we put a piece in place -- and you begin to work with it and we see how it evolves -- we have to make some changes in it, and perhaps you have to make some changes. But then other things begin to happen.

We talked a couple of years ago about removing 390, and interestingly the exchanges suddenly created something called ITS. It does not work perfectly, but it works a lot better than it did two years ago. It needs to be faster. It needs to be linked with Cincinnati and the NASD -- it needs work. It will, undoubtedly, need other changes and improvements as time goes by.

Then along came a group of people with something called Cincinnati. Again responsive, as elements of the industry should be, to opportunities in the marketplace as they perceive them, they introduced a new system or a new mechanism which might further the development of the national market system. Cincinnati has work to do. It is generating a lot more interest at this point, undoubtedly, because of the involvement and backing of Control Data, and perhaps also because, just as with ITS, we have now granted it a three-year lease on life to encourage people to participate in it. It needs to be linked. It needs to get its quotes in more effectively than it is getting them in now, and it needs work.

The exchanges are now working on a limit order concept that we are watching very carefully and are interested in seeing how it develops. We made clear in our release this year in March what we would expect such a facility to do. I would hope and expect that the exchanges will come forward with a response that will fulfill the spirit of our expectations.

And in the last several months, I think two very important developments have occurred. The most significant, undoubtedly, is the NASD proposal for the automation and and linkage in relation to NASDAQ, I look upon that proposal as a response to a changing market -- a very appropriate, timely and important response -- and one that clearly, I am sure, is stimulated, at least to some extent, by the prospect of Rule 19c-3. Without indicating anything about the disposition of 19c-3 in any way, I would say that the proposed linkage is a timely concept that should be implemented regardless of 19c-3.

And finally, Merrill Lynch, two weeks ago, announced its best price selector -- a potentially important development on the part of upstairs to reach for the best market. It shows what can be done in a reasonably short period of time and reasonably inexpensively when the industry sets out to do it. It also adds another dimension to the importance of accurate, timely and firm quotes. It also reminds us that some of these pieces will be in place before all the other pieces are and, therefore, before they can be as fully effective as we might expect them to be. All very important developments.

Discussions have been going on for over a year now, perhaps even longer, between the New York, the AMEX and the regional exchanges on the switch. We would expect that those negotiations would be fruitfully concluded in the near future. It is important that the switch be available and that the exchanges come to their agreement in connection with it.

We have three proposed rules out on price protection, on qualified securities, and on the over-the-counter trading of newly-listed securities. They are all significant. They begin to engage you as over-the-counter market makers much more directly than perhaps some of the other rule proposals. They present some important and serious problems that cannot go ignored, over time, that we will have to deal with and put to bed in one way or another. Fragmentation and internalization are issues that keep coming up in all of the Commission rule proceedings and we are just going to have to resolve them in an appropriate way.

In summary, I feel very encouraged by the progress that is being made in the national market system. We are far from there. The issues are teed up. The hard question -- the ultimate question -- is whether we can keep it moving along at a pace that is acceptable, at a pace that is responsible and responsive to the Congressional directives, and particularly whether it can be achieved by leadership coming out of the industry -- not necessarily by a united industry. If you look at the various components that have been put in place, they were not done by unanimous consent of the industry. They were done by segments of the industry who saw an opportunity to serve their own interests in the context of building a national market system -- and that is fine.

I would urge upon you that a national market system should be built by people who are living and experiencing the marketplace. The systems components should be able to stand on their own in terms of economics and in terms of their usage by the industry -- and in terms of the extent to which they are trusted by the investing public. Those should be the criteria.

The system should not be designed and implemented by the federal government. We do not have the expertise. Do not back us into a position where we have to do it because it is not being done by the private sector. That is a dynamic that we have to shift, not only in the context of the national market system, but in a lot of other ways in this society. We have got to get the initiative for the movement of this country back on the people of the country where it belongs and out of Washington where it does not belong and cannot be dealt with.