

The Economic Club of New York

70<sup>th</sup> Year

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General Alexander M. Haig, Jr.  
Supreme Allied Commander Europe

The Honorable Roderick M. Hills  
Chairman, U.S. Securities and  
Exchange Commission

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Questioners: Robert Hotz  
Editor and Publisher  
Aviation Week and Space Technology

Lee Seidler  
Professor of Accounting  
New York University

## Introduction

Chairman James W. Davant

Chairman Hills, members of the Club, and guests, it is a pleasure to welcome you to our dinner meeting this evening. I hope everybody's having a lot of fun. This is the 70<sup>th</sup> year of the Economic Club of New York and we have a program that is both timely and interesting. The question period, as most of you know, is a feature of these meetings. It will begin after both speeches have been completed. Mr. Robert Hotz, editor and publisher of Aviation Week and Space Technology will question General Haig. Mr. Lee Seidler, Professor of Accounting at NYU, writer, lecturer, consultant, will question Chairman Hills. Answers to the questions asked by Mr. Hotz and by Mr. Seidler will, as always, be spontaneous and unrehearsed. And I can really assure you that there's been no previous consultation between the questioners and speakers. Can you hear my alright? You're lucky. Now can you hear me? You're very fortunate this evening.

Our first speaker began as a newsboy and did time as a floor-walker at Wanamaker's in Philadelphia. And by the time he was 47, he was a Four-Star General. Two years later, he became Commander in Chief, United States European Command and Supreme Allied Commander Europe. He is a soldier who has distinguished himself in combat. But those who know him best tend to describe him as the ultimate professional, a man who has set for himself the very highest standards of competence, of conscientiousness, and integrity, as a soldier, a

diplomat, an administrator. And the worst thing that critics seem to be able to say about him, that he looks more like a matinee idol than a military man. He is a man who, as one national commentator put it, has paid his dues again and again and again. So we are grateful for this opportunity to acknowledge our indebtedness to a great American soldier who in times of the greatest stress has performed, with a quiet strength, whatever task this country has put before him. Ladies and gentlemen, General Alexander Haig. (Applause)

General Alexander M. Haig, Jr.

Supreme Allied Commander Europe

Thank you very much, Mr. Davant. Very distinguished members of the New York Economic Club and guests, I can't tell you how pleased and honored I am to have this opportunity to speak to you briefly tonight. I'm only too conscious of the great reputation of this organization over the years.

But I must admit I'm also titillated because as you know in my current responsibilities I frequently find myself speaking to multilingual groups. This is a constant source of difficulty and embarrassment for me. In fact, just the other day in our mess at SHAPE we had a German war ace, General Richter, who was regaling two British and two American officers about an experience he had in World War II.

The story went something like this. (Speaking with a German accent) “We was conducting a raid on the Eastern Front against Moscow, und I had mean focker on my right und a mean focker on my left.” And I said, wait a minute, General, please! I said these gentlemen may not understand German and they should be aware certainly that a Fokker is a German aircraft manufacturer. They had a bi-wing fighter in World War I and a high speed fighter in World War II. And my friend, General Richter, looked at me, he said, “That’s very interesting, he says, General, but these two fockers were flying Messerschmitts.” (Laughter) So occasionally you have to be very difficult.

But I do want you to know as I go around from capital to capital trying to discuss the importance of this NATO Alliance, one question that always comes up is, General, do you still have the vigor in your leadership that our great World War II experience confirmed? And I’d like to recount to these questioners a story about a French general who has since retired; he was a member of SHAPE Headquarters. At the time the French were still integrated in the military command. He’s now living in Paris.

Recently his wife reached her 80<sup>th</sup> birthday. Now simultaneously with that octogenarian milestone, she rose in the morning with dizziness, nausea, it followed her through noon. She finally ran to her doctor and said, Doctor, I have this terrible problem. He examined her thoroughly, blood tests, X-rays, metabolic measurements. He was quite concerned. He said; go home, I must counsel with some experts.

He called her back a week later. He said, Madam, best you come to my office for the diagnosis. She arrived there. There were a whole battery of specialists. He said, Madam, best you sit down for this diagnosis. She sat down and he said, Madam, you are pregnant. She looked at him. She said, Doctor, that's impossible. While I am 80 years old, my husband is 85. He said, Madam, we've given you every test known to modern medical science. It's irrefutable. You are pregnant. She leapt up from the chair, ran home to tell her husband, found he was at the club playing cribbage. She called him on the phone. She said, you old goat, you got me pregnant. He responded, and who is this calling? (Laughter) So you see, we haven't really lost our vigor despite what you may suspect.

But you know, in a more serious vein, as you look at this great collective effort that has sustained the Western world and its freedom since almost the end of World War II, and you view the difficulties on the strategic horizon, whether they be the so-called burdens of the socioeconomic crisis which have placed such great difficulties on the laps of our executive branches throughout the alliance as they hope to meet the needs for our security. As you measure the so-called dilemma of detente, and the confusion that that has generated among the peoples and in the capitals of its full membership.

As you look at the southern regions of this great alliance, starting in the west with a post-Revolutionary Portugal, a post-Franco Spain in an evolutionary process moving left, the pressing internal political problems of modern Italy, and those longstanding, persistent and continually

intractable animosities between two great allies in Greece and Turkey. And I must admit from my perspective in Europe, as you look from time to time to the worrisome signals emanating from our own capital, starting with the calamitous outcome of the conflict in Southeast Asia, the hemorrhaging of national security information, and the appearance of a masochistic destruction of our intelligence structure itself. As you observe the revelation of so-called military industrial scandals which were handled in less than deft fashion in our own capital. As you observe an Angola, and the continuing difficulties between the executive and legislative branch in our country, all of these factors merge against a backdrop of what has been described as a relentless growth in sheer Soviet military capabilities and have caused very many serious people to ask themselves whether or not this great alliance that has procured some 27 years of peace with progress, at least in Europe, has not outlived its utility. And whether or not some substitute formula or mechanism should be devised to provide for our continuing security needs.

Now I doubt many in this room would accept that thesis. But certainly these continuing difficulties make it incumbent upon all of us who bear responsibilities within this alliance today to examine most carefully the premises of such a challenge. Now I would hope that we would reject the current penchant for instant analysis in which today we find one or another event on the strategic horizon bisected and dissected by an over-abundance of journalistic skills. And sometimes sweeping, almost universal conclusions are drawn from these events only to find us sadly disappointed as they are tested by time.

And rather, I think, step back very briefly with me this evening if you will, and look at some of the more fundamental aspects of the emerging strategic environment. Now I'd like to do this in a compressed and over-generalized form at the risk of the kind of imprecision that my interrogator might care to plumb in the question period. But in doing so, I think first as a military man, you want to hear some assessment of the threat. But rather than starting with the esoteric hardware aspects of this problem, I think it's important that we view the fundamental geopolitical character of this threat.

You know some 27 years ago this great alliance was spawned in an atmosphere of threat which was easily perceived and relatively easy to devise strategies to cope with it. We had what historians referred to as a monolith dominated by so-called democratic centralism which is Marxist jargon to describe a degree of discipline emanating from Moscow throughout the Marxist Socialist world that was indeed something to behold. It was a threat easily perceived. It was introverted, highly polemic, and limited in its geopolitical power base to resources which confined Soviet activity essentially to re-shoring and shoring up those territories acquired in the great conflict.

But how that picture has changed in the intervening years. Today we see at least three centers of Marxist power and control – one in Moscow, one in Peking – and a third group of revolutionary developing states for whom the other two are constantly vying for influence and control. On any key strategic issue today, you may find the animosity between Moscow and Peking greater than

between either in the Western world.

And I think as we view the agenda for the future, especially with recent changes in Peking and a drift to what has been referred to as moderation, but is inevitably pragmatism, it is clear that the degree to which we in the west hope to realize benefit from this fragmentation of Marxist power, is the degree to which we are perceived by all of these centers of power as relevant, reliable, and consistent in the broader sense of those terms. And to the degree that we fail to present that perception, do we not leave these various centers of power with no other option but to work out their own vital destinies exclusive of Western concerns.

Now in purely military terms, I know, especially in a pre-election period we've been exposed ad nauseam to these threat calculations, I'd like to describe in brief net assessment terms and always in the context of our so-called NATO triad of forces – central strategic systems, theater nuclear systems, and those conventional land, sea, and air forces, which today guard western frontiers.

With respect to central systems, I think Don Rumsfeld has correctly described it as a situation of rough equivalence. That is the successor to essential equivalence which in turn succeeded parity all in the direction of greater flexibility as you make your calculations. (Laughter) Now one thing is clear as we view this rough equivalence. And that is that there is a dynamism in the Soviet building program with four new ground-to-ground rockets, three of which are MIRVed, all of which have demonstrated in tests highly increased accuracy against hard point targets.



As we view the deployment of the SS--8 and its successor, SS--18 submarine-launched missiles that can sit submerged in the Bering Sea and strike targets throughout the North American continent including the Panama Canal, all of Western Europe, and a large part of Communist China, it is very clear that if we are unable to achieve acceptable, just caps, on this momentum through SALT agreement, that the West is going to be faced with increased spending primarily here in the United States to maintain this so-called rough equivalence. And as we assess the character of the Soviet building program to include its civil defense augmentations, I wonder whether Soviet leadership has accepted the current Western proposition that central systems are only political in character and that nuclear exchange can have no winners.

As we look at the theater nuclear system again, the picture is highly dynamic. We see an increase in Frogs, Scuds, scaleboard missiles, ground-to-ground rockets facing ground forces in Western Europe with increased accuracy and follow-on systems on the drawing boards. We see the probable deployment of artillery rounds for their 152mm and 203mm cannon. We see a fundamental change in the character of the tactical air arm facing us in Western Europe today. You know two years ago I could come here with some comfort and tell you that a two-to-one inferiority on the part of the West was more than compensated for by qualitative limitations on Soviet offensive air arms. That picture has changed with the introduction of third generation aircraft into Soviet inventories.

We've seen in recent months a doubling of the range and a tripling of the load carrying

capability of these aircraft. And whereas two years ago their qualitative limitations limited them to an essentially air defensive role over Warsaw Pact territory, today they are a dual capable threat against the territories of Western Europe. And finally, I know you've all read recently about the soon-to-be deployed SS-X-20 medium-range missile. This is a missile to be deployed in the months ahead with multiple warheads in a mobile configuration and with dramatic quantitative and qualitative improvement in the Soviet tactical theater capability.

Now the area that has been of greatest concern to me, because it is indeed the area of NATO's greatest deficiency, is our ground, sea, and air conventional forces. I don't have to tell you that a million men have been added to the Soviet structure in the past decade, 130,000 of which appear before us in the central regions of Central Europe. We've seen a 40% increase in their tank inventories, a 50 to 100% increase in their conventional artillery, and a doubling of the sustaining base of these forces at the time when Western armies are racked with improving tooth to tail ratios.

I've already described the fundamental changes in the Soviet air arm which is now essentially offensive in character. And I think with an audience such as this in a great metropolitan center such as this, I need not highlight the fact that over the past decade the Soviet naval capability has emerged from what was essentially a coastal defensive force a decade ago to a force which today poses a threat in global terms – lifelines of Western industrialized nations.

Now what does all of this suggest? Well, firstly it suggests that that Soviet threat of a quarter of a century ago is no longer continental in character but is indeed global. And that it provides a sustaining base for the introduction of an imperialist phase in Soviet foreign policy. It suggests as we weigh the priorities established by Moscow for the distribution of these vast resources that the first priority goes to those forces facing our armies in Western Europe in terms of manpower resources and modernized equipment.

Now while it suggests that this is a strategic priority for Soviet war planners, as indeed it should be because it guards the gateway to the heart of Europe, it does not suggest that it's the modus operandi for the period ahead so long as we maintain the essential vitality of our current deterrent. And I suggest as we look for the crisis situations in the decade ahead that we are going to see an extension of those same ambivalent, ambiguous crisis situations which have emerged on the flanks and in the areas peripheral thereto which are a product of the dynamics of change of the Third World and which may in the first instance not even be the consequence of a conscious decision by one of the superpowers but which by their very dynamics can increasingly draw in those vital interests with all of the grievous overtones of a major confrontation.

And I suggest as we view this military challenge facing the West, it is clear that in a period of strategic parity, Third World dynamics, multipolarity, that regional military balances, in-place forces available to Western diplomacy to cope with these emerging Third World dynamics are indeed the essential tools that Western diplomacy must have to prevent either defeat by default

or the escalation of these crises into unmanageable superpower confrontations.

Now no strategic overview would be complete without a word about the changes and the metamorphosis in this great nation of ours. You know at the outset of this alliance we emerged as a nation totally superior with a nuclear monopoly, with an industrial base that had literally exploded during the early conflict years, and with an armed force second to none. And most of all, with millions of young Americans returning to our shores having seen this great globe for the first time and imbued with a conviction that it was the American style, the American innovation that had brought about the successful outcome of the conflict. And that if somehow we as Americans could just translate our political, economic, scientific, and military know-how to our friends and former enemies abroad, if we could just do this, that never again would the world have to bear the sacrifices that World War II represented.

But how that picture has changed over the intervening years. A decade of Third World experimentation in the 60s, resulting frustrations, fundamental changes in relative power between ourselves and the Soviet Union, have indeed deprived this great nation of that unique, hegemonic power base which enabled us in the past to move unilaterally in and out of global crisis situations and bring about outcomes that met the vital interests, not only of the United States but the free world as well. And I suggest, as we view the decade ahead, we Americans must clearly understand the true and sober limits of American power in the decade ahead.

And you know, equal changes have occurred in Western Europe. Where at the end of the great conflict, they found themselves prostrate, devoid of all of those demographic power increments so essential for true and complete sovereignty. But in the intervening years they're back on their feet, by any measurement of demographic value you care to apply, and are today actively competing with Americans for markets at home and abroad. Most of all, our European friends who at the outset of this alliance had their hearing aids open, and their hands out, and thirsted for American hyperactivity and leadership, have turned those hearing aids off. They will work with us in cooperation and in partnership, but not in the subordinate role.

But, you know, with these two changes weighed together, I remind our European friends that just as America has lost its unique hegemonic superiority, as you have regained your vitality and organic health, so too are the days gone when you can sit on the sidelines and watch the United States competently or incompetently move in and out of global crisis situations and bring about outcomes that meet your vital interests. Those days are gone for our European friends as well.

Now I think again, any strategic overview must include a brief word about the Third World. You at the end of the great conflict and the emergence of this alliance, we used to view that problem of emerging leadership of those nations just relieved of the yoke of imperialist domination as one that was essentially economic in character. We felt if we could just provide for the equitable distribution of wealth among these emerging societies, that they would opt for moderate political solutions. Many of us believed that they were flirting with Marxism because it provided a

formula for the equitable distribution of wealth. How wrong we were. Those nascent leaders weren't flirting with Marxism then anymore than they are today to distribute wealth. They were searching for a disciplined system through which to exercise political control and they would take care of the dividends of that control.

And despite our idealistic viewpoints of the late 50s and early 60s, almost without exception these emerging Third World entities have opted for dictatorial models of the right and the left. And again, as we view the agenda for the future, we must understand that uninhibited by the restraints of more pluralistic political structures, these entities are going to be capable of the most precipitous shifts in alignments and policies. And if we learned any single thing in October of 1973, it was that as we attempt to work out a just and responsible relationship with this emerging Third World, we must do so as a collective of consumers or we will find ourselves exploited in detail.

Lastly, I would like to comment very briefly on what I have described as a so-called socioeconomic crisis which is a fundamental aspect of the strategic environment I have been describing. Some would claim that it is a typical, traditional, cyclical, fiscal upturn, downturn dilemma of the character of which we have experienced since the great conflict of World War II. And indeed it has those cyclical, fiscal overtones. But even in that context, it is fundamentally different because for the first time all Western industrialized nations are experiencing the phenomenon simultaneously. And we have been deprived in the West of that traditional

flexibility for one nation on an affluent rise to move in and bail out another at the low ebb of the trough with some prolongation in time and indeed considerable increase in its density.

Now in addition, however, to these fiscal aspects of this crisis, there are other ingredients that we dare not overlook. I'm talking about the crisis of egalitarianism and the great burdens that have been placed on the executive leadership of all of our nations as they seek with justice and responsibility to distribute the products of the success of Western industrialized systems. I am speaking about the dilemma of raw materials, which for the first time place Western nations with definitive limitations on the very materials that have spawned their growth since the Industrial Revolution. And I'm talking about literal explosion in communications, the television, and the impact that it's had on the mainstream of thought in the societies of each of our nations.

Now I would suggest that all of these factors pose a fundamental threat to the system itself. And indeed, as I have traveled from capital to capital, if there is one single impression I have left with, it is the commonality of the nature of the problem facing each and every one of the Western nations. And because it is common, it demands common, integrated solutions. And I must tell you, I'm encouraged as I go from capital to capital, that this consensus is increasingly developing. \_\_\_\_\_, Puerto Rico, short perhaps on action, stronger in terms of cognizance and consensus, all confirm the growing awareness of the interdependence of Western nations.

What really bothers me is that many of our Western leaders believe that this crisis is so pervasive

that they can afford to divert resources traditionally applied to the security sector to feed the so-called socioeconomic crisis. And I warn these leaders that they are indeed upon a stillborn course because I can assure you, no collective socioeconomic endeavor will succeed if we undercut the bedrock of confidence and security that our people must have in our security relationships. And any Western leader who believes he can simultaneously feed socioeconomic demand while undercutting fundamental confidence in our security is upon a course which is going to unleash fundamental nationalistic self-interest.

And so, I think this is the lesson of any careful analysis of today's strategic environment. And what are the fundamental lessons that I've described? First and fundamentally, interdependence between Western industrialized states, politically, economically, and in the security field. Secondly, the overriding burden of managing emerging global Soviet power which today provides a base for an imperialist phase. And if events in Angola suggest anything, it is that at least Soviet leadership is flirting with the introduction of such a phase. Finally, it confirms that as we hope to meet these multitude of challenges, we must continue to do so under an umbrella of confidence in our security relationships and no Western leader dare undercut that fundamental reality.

Now, you know, there are those that would suggest that the agenda I have just outlined is undoable. I reject that thesis. When you view this great Western industrialized world from Japan and the Pacific through the North American continent to our friends in Western Europe, it's clear



that we are discussing twice the industrial base, one and a half times the manpower of any conceivable conglomerate of Marxist parties. And clearly, the task ahead is merely to recognize the gravity, to establish the will, and to set our priorities. Thank you. (Applause)

Chairman James W. Davant: Thank you General Haig. I'm delighted that the speakers were working. In an often quoted remark, Charles Kettering once reminded a business friend that the people happily weren't getting as much government as they paid for. He was saying, I suppose, that in running a country as in cooking a fish or making a speech, less can be more, that there may be some connection as Meacham(?) suggested between President Coolidge's afternoon naps and the tranquility of his years in The White House.

The same spirit might also be applied to the job of regulating an industry. In an earlier incarnation, our next speaker helped found the Los Angeles law firm whose practice, common among missionaries but not common so much among attorneys, was to award sabbaticals to the working partners. Some people would suggest that this policy, almost regardless of the cost to the taxpayers, could be applied profitably to the Securities and Exchange Commissioners. And there are some in this room who might even suggest that the commissioners take their leaves collectively and simultaneously. (Laughter)

Chairman Hills is a private man so we know only a very few trivial things about him. We know that he prefers tennis to golf and white wine to red, but as a public figure we know him to be a

man of high principle and rare good humor. Perhaps most important, we know him to be a regulator, who in part perhaps he has been one of the regulated, understands clearly the limits of regulation. Ladies and gentlemen, Chairman Roderick Hills. (Applause)

The Honorable Roderick M. Hills

Chairman, U.S. Securities and

Exchange Commission

The thing that bothers me about General Haig's speech is that it sounds exactly the way I talk about how we are having trouble creating a national market system. When General Haig talks about the Third World, it translates to me into the third market. It also bothers me somewhat, Jim, that in the old days you used to have the Secretary of Commerce or someone of that background speak with the Chairman of the SEC – Bill Casey told me that was the way it was. But starting with Ray Garrett, you've got the Secretary of Defense, now you have a general of the armies, it looks like we're in real trouble up here – quite contrary to the sense of warmth that I have on the occasion.

Let me speak briefly about how I see the world we're all in together. Just one week ago at an American assembly in Upper New York at a fine resort setting, I had the chance to spend three days with 29 economists, mostly professors, some 23 corporate officers, mostly vice presidents of finance, and a half a dozen fine, well recognized financial writers to talk about capital

formation. I was impressed by a number of things from that three-day adventure, not the least of which, of course, was the professional treatment that this assortment of people, and I might add equally distributed amongst us were Democrats and Republicans, the capacity to give professional treatment to the myriad of governmental policies that affect the ebb and flow of capital.

There were differing views of course, conflicting theories, conflicting definitions of the issues, conflicting data, conflicting predictions. Nonetheless, the group was able at the end of our three days to come up with a simple statement of policy about the future. We said in a unanimous statement, tax policies result in inefficiencies in the allocation of capital. Regulation distorts prices; regulations that distort prices curtail investment. Inflexibilities imposed by law in financial markets cause misallocation of saving. We concluded we must design our regulatory policies, our tax system, our financial market policies in ways that reduce impediments to investment.

Simple enough, I suppose, for all of you. Common words, common views that we've shared amongst us for years. But on my return from that meeting, I was prompted to wonder if so diverse a group could so clearly see and describe the path to real economic growth, why is it that our leaders in business and in government have not been able to put us on that path? Why have we not, after all these years, been able to make those 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, and I surely include myself; pay only lip service to the notion of free enterprise.

We content ourselves but confuse the public with shopworn slogans – free enterprise, balanced budgets, no deficit spending, deregulation, capitalism. Surely we have used them now enough for so many years to know that they are not stirring either the hopes or the votes of the American public. The sad fact is that the American people have lost interest, maybe faith, in the free enterprise, competitive system that we call capitalism. They lost interest because they do not believe it's free, they do not see enough of the commitment to competition, and a capitalist still sounds to them too much like another one of those fellows that won't tell the truth.

I suggest this evening that a new philosophy for free enterprise is needed – one for which government and business will provide consistent support. A philosophy centered on this 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 effect the changes in regulatory and tax and financial market policies that are so critically needed unless the public does accept such a philosophy. And I similarly see very little chance of such public acceptance unless the business community can convince first itself and then the public that free market competition is, in fact, a better regulator than government. And unless, having done that the public is assured that the business community

will act responsibly, if freed from some degree of regulation. From the perspective of two years now in government, I see us in a somewhat precarious balance. Either we will make progress toward a freer market economy or there will be an inexorable trend toward greater regulation.

Let me speak this evening very briefly to these two points – faith in competition and faith in the competition, faith in the capacity, excuse me, of business for self-government, self-discipline. I'm sure that 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 that the public disinterest in free enterprise comes in significant part from this apparent disinterest of much of the business community and the free market system.

There are far too many examples– the transportation industry, the communication industries – of industries which have long been reluctant to be exposed to full competitive pressures. We know too that the absence of competition will necessarily bring more government regulation, regulation that can stifle profit on the one hand or regulation that can preserve levels of profit so high on the other hand that businesses are tempted to evade regulation with kickbacks or other economic concessions.

We saw the latter in our industry, in the securities industry, when fixed commission rates regularly brought give-ups and reciprocal payments to large institutional investors. We see it now tragically in the shipping industry with recent disclosures of millions of dollars of illegal

kickbacks and rebates apparently used to get business from shippers that wanted lower rates than they could get out of the fixed rates.

Most of you must have noticed earlier this year that Russia was cutting its prices on the Atlantic Ocean for shipping. It occurred to me at the time that there must be some special place in a supposed Hall of Fame for socialism for those people that created a system that somehow was able to persuade the Russians to give up price cutting and join the Western world's system of rate-fixing bureaus. (Laughter) It really is axiomatic that opposition to government and its regulatory authority increases in direct proportion to the distance that one's own economic interest lies from that regulation. The small businessman, who more than any other person suffers from government regulation and the paperwork it spawns...(Audio ends and continues, no overlap)...better than the chairman of General Motors said it a few weeks ago. If you want to be allowed to compete, you must be willing to compete.

Let's suppose for a moment that we could convince everyone, including ourselves, that competition is the better regulator. Could we convince the public that our system of corporate governance is acceptable? Or will we as a nation insist on a far greater and more rigid federal control on corporate decision making?

Criticism about corporate governance has been crystallized this year in Mr. Nader's new book. He there speaks easily about a corporate arrogance that he says pollutes, bribes, fixes prices at

will, and spends billions of dollars advertising the virtues of its activities. To control these alleged aggressions, his book proposes that federal chartering be put into place, to put major corporations under firm federal control, and to place public interest and employee representatives on the boards of these same corporations.

Again, 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, not just of our corporations but on our society. Arguments for and against such proposals have too often missed the point. Debaters argue over whether the nature of his claim of corporate abuse has been exaggerated. A far more constructive effort would be a candid evaluation of how our corporations are now governed – one that admits shortcomings, but one that attempts to tailor remedies to correct those precise shortcomings.

If we were to have such an imaginary debate, it would deal with three separate issues – corporate behavior that is contrary to the law, corporate behavior that is contrary to good management practices, and corporate behavior that is contrary to someone's notion of good public policy. So stated we would ask with respect to each, is some form of greater federal involvement, like federal chartering the answer? First, would it provide more effective law enforcement? If you say yes, surely you would be ignoring one of the most successful law enforcement efforts, whether you agree with it or not, in our history – an effort still underway at the Commission to uncover a long list of foreign payments, domestic payments for questionable purposes. Twenty-two

successfully concluded prosecutions and 200 corporations that have made disclosures they did not make before.

Why was such a success of law enforcement with so many people not on the firing line so easily proposed sweeping changes in the law? Do they really want to scrap a system of corporate self-governance enforced in varying degrees by the SEC for now more than 40 years at the very time in its history that it's proved to be the most effective? Or will the public, Congress, and business accept our view that the proper course is to institute tighter internal audit controls, place a bit 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 and not of this so-called public interest sector. It's not a glamorous solution, that's its worse problem. It's not one that will bring headlines to its sponsor. It has only the virtue that it might work.

Second, would federal chartering cause our corporations to be managed better? I don't think so. But again, let's see if we can agree with what's wrong with management 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 criticize him severely in front of his fellows. Compensation for directors is too often set at figures so low that no real work is expected. Information provided boards in many cases is the product solely of management. Outside directors feel no responsibility to make independent inquiry. Inside directors control the vote too often on salaries,



on merger and tender proposals, on management succession, on the filling of board vacancies, all matters where the stockholders' interests could be different than that of management.

Stockholder democracy, therefore, in so many cases 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 and wish to monitor and change management where it's important to do so.

But what is missing on so many boards is quite clearly present on others. We do have, certainly more so than any other country in the world, splendidly performing boards that have effective, responsive, and responsible directors. As we look for a remedy to a perceived problem, therefore, it is far more sensible to encourage the poorly performing boards to emulate this model of successful companies. Far more sensible to do that than to experiment with a system that has worked nowhere. We can look to Xerox, General Motors, Connecticut General, Texas Instruments, for examples of independent boards rather than to the quasi-governmental corporations that are being spawned abroad with far too great irregularity.

The essential first step, of course, is to create some form of panel of outside directors that will have both the practical ability and the perceived interests in securing 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 management put them at potential odds with the interests of stockholders.

These, I say to you, are the enduring truths that are governing more and more corporations in this country each year. And these, I believe, are the considerations that led the New York Stock Exchange just last Thursday to proclaim that it will change listing requirements to require independent audit committees. We can, therefore, reasonably conclude – if we want to be reasonable – that a better form of corporate management is underway. It's engaged in a process of change not dictated by government, but propelled by good economics, by the self-interest companies ought to have in attracting investor attention.

In contrast, can anyone seriously argue that federally chartered boards with public interest directors will create better managed companies? Is there really anyone in this audience that would prefer to put your investment in the hands of directors who have some form of ill-defined obligation to the public good, to an ambiguous public policy?

That leaves only, as I see it, 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 in statutory mandates? It is tempting to put public interest directors on a board to speak for employees, for environment, for a better life, however it might be defined. Sure, it's difficult for Congress. How can Congress balance between needed economic growth and environmental improvement, between the need for profits, safe working conditions, safe products? Why not put the hassle on the boards of directors and make the board accept this kind of broad public responsibility?

The answer, of course, as we can see so tragically in Europe, is that it won't work. When governments have tried to use corporations as instruments of government policy, the corporations become less efficient and the countries become less democratic. I dwell on corporate governance because our business community is the nexus, the interconnecting link of capitalism. If there is no faith in it, if it does not function effectively, legally, if it is not perceived by the public as so functioning, and if the laws we pass as a result with respect to that business community are not carefully targeted to real problems, our free market system can erode into one that is non-competitive, less innovative, more concentrated, quasi-governmental, less efficient.

Thus, we need to encourage responsible criticism. We need more here who will agree with the type of comments that were made by the president of the Bank of America who said integrity is the foundation of our ability to do business. If the market economy ever goes under, our favorite villains – socialist economists and government regulators – won't be to blame. We will. We need more who will seek effective changes in corporate governance as has the current chairman of the New York Stock Exchange, who is only now in 1976 fulfilling that organization's 35-year old goal of creating independent audit committees on our larger corporations.

I mentioned earlier the call of an American assembly group for a redesign of our regulatory and tax and financial market policies in a way that will reduce impediments to investment. With a strong, consistent, and candid commitment to competition, and responsible corporate governance, there will be many in government, many who have been there for many years, who

will help clear the way.

Let me cite briefly five inter-governmental initiatives that we have commenced at the Commission in recent days. 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, I think, unintentionally contributed to a grave imbalance between debt and equity. Second, we seek to eliminate taxes levied on corporate profits that are not profits in a real sense, in a real economic sense, by reason of inflation. Third, we seek to put all investment funds, whether under the jurisdiction of ERISA, the bank regulatory agencies, or the SEC, under the same regulatory standard to eliminate all artificial barriers, which prevent certain kinds of investment from having access to those funds. And simply to permit full advertising by those funds of the performances they've had in the past. Fourth, we shall attempt to entirely redesign our regulation of venture capital efforts. And finally, we have only now – I am sorry to say – begun to reconsider the existing rules under so-called 11A that will in 1978 effectively prohibit members of exchanges from doing both a money management business and a brokerage business for the same customers.

With the whole industry becoming far more competitive, there seems to me to be serious questions as to whether or not this kind of artificial restriction should be maintained. The efforts, I'm sure, seem modest, but they mean something new. They mean that the Commission recognizes that it has the same kind of responsibility to work for the removal of artificial

impediments to capital formation that it has long exercised with respect to abuses in the system of capital formation. We have just as much job to clean it up for purposes of accelerating capital formation as we do to stop the abuses that we see along the way. More important, you can look throughout government, agencies and departments everywhere that could build a similar list of impediments that need to be cleared away – a list that can be maintained, a list that can be worked on if the climate for change can be created and maintained.

I spoke at the outset of a failure of leadership, but that does not mean an absence of leadership. President Ford has certainly given full support for responsible regulatory reform, and the President-elect seems to be equally committed to the same course of action. The point of my remarks this evening is that reform can either strengthen or weaken our capital markets based upon 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.

I could not possibly appear before this group to talk about leadership this evening without paying a special tribute to a leader whose help will be sorely missed in the years ahead. I so very much regret that I did not have the opportunity to know Gus Levy longer. I met him barely a year ago when he was the supposed symbol of Wall Street as it was – of the status quo. We lost him last week, only a few days after he played perhaps the key role in creating a new spirit of accord that holds at least the promise of creating a national market system amongst the industry throughout

the country, a system that could be truly competitive.

I've enjoyed being with you tonight and I've enjoyed very much the chance to serve at the Commission amongst all of you this past year. I must say to you that I hope you share my own view that as the year has gone over, as the year has come forth, there has in fact been some spirit of accord that holds the promise of some constructive change. For that I thank you and I particularly thank you for the chance to be here tonight. (Applause)

#### QUESTION AND ANSWER PERIOD

CHAIRMAN JAMES W. DAVANT: Thank you Chairman Hills. I have a problem now. I want you to do two things. I know you'll do the first. I hope you'll do the second. Will you stand up and stretch and then sit down tranquilly, just for a moment. I know I speak for the audience when I suggest that questions be brief and clear. Likewise, the answers. Mr. Hotz will begin and then the questioning will alternate between the two panel members. Mr. Hotz.

ROBERT HOTZ: Thank you. General Haig, you very eloquently described the fundamental change in the character of the Soviet and Warsaw Pact buildups in Eastern Europe from a basically defensive posture to an offensive posture. And this has given rise to some recent Senatorial criticism that NATO, as presently organized, is organized to fight the wrong war with too little warning and with too little intercontinental logistic support from the United States. Do

you believe this is a valid criticism? And if so, what do you think NATO ought to be doing about it?

GENERAL ALEXANDER M. HAIG, JR.: In the spirit of the three admonitions I've already had, yes and no. (Laughter) I think, first with respect to the question on warning which is increasingly a matter of focus. And the problem with it is that we have to be very careful about what I refer to as the old dialectic, what Henry Kissinger refers to as these dialectic switches from excess complacency to excess alarm, when the truth is somewhere in the middle. Now with respect to warning time, we have indeed two conflicting trends. The one being the technological assets that are increasingly being added to Western inventories, I'm talking about overhead photography, electronic surveillance, and the whole range of technological acquisition techniques that we have today to warn us of preparatory measures being taken by the Soviet Union. Against this is another generalized trend which is more a direct product of the force improvements I've described, and which rather than subjecting us so much to what has been referred to as surprise attack, and I reject that theme because we're not going to be surprised, we spend all of our time trying to prevent that phenomenon, but as so, we have forces in place getting increasingly strong, they develop the capability to attack without reinforcement. And indeed, as they look at our deficiencies in the West today, where they have 2 to 1 superiority in manpower, 3 to 1 in tanks, and 2 to 1 in aircraft, it becomes an increasingly inviting option for an aggressor should they decide to attack because we are highly dependent as Western democracies have always been on mobilization post-attack. Now as you mull these two conflicting trends, it is

my assessment that we are fundamentally netting in the direction of less warning, greater ability of the Soviets to launch attack without mobilization, and with that, the incumbent requirement on the West to improve our in-place readiness. And today we have a full-blown program which was launched two years ago in NATO Europe that provides for improved readiness of in-place forces, increased rationalization of our defenses. That is, standardization and greater integration of our forces through exercising common doctrine, common defense concepts, interoperability of equipments, communications, and fire power. And finally, we are working intensely today on our ability to reinforce rapidly in time hopefully of crisis. You know if we learned anything in the decade of the 60s, it is the best way to prevent a crisis from becoming a confrontation and open conflict is a credible action program designed to improve your forces and to demonstrate your will. And we have to develop and improve the political consensus to adopt that kind of rationale in crisis management in the future. Have I answered your question?

LEE SEIDLER: Mr. Chairman, much to the relief of some of the members of this audience, the most activist chief accountant in the history of the Securities and Exchange Commission recently resigned to take a position as Deputy Mayor for Finance of the City of New York which some have described as the second mate on the Titanic. (Laughter) Common gossip in the academic circuit has it that the position has been offered to Professor Sidney Davidson at the University of Chicago, Professor Charles Horngren of Stanford, and that you still do not have a chief accountant. Could you enlighten us as to the progress in filling this position and as to whether the apparent previous offers suggest that it will be filled with another professor?



THE HONORABLE RODERICK M. HILLS: There's an awfully easy answer to that. The position is not filled. I don't have any, to be serious for a moment; I don't really have any personal sense that we need an academician to fill that job. (Applause) And you've got me on delicate grounds because, one, I couldn't possibly offer a job to anybody without a vote of three commissioners. But if you were to ask me, I would have liked very much to have Sid Davidson take that job, mostly because one of the people I admire most in the world is George Shultz and George called me – I used to come down on Thursdays occasionally when he was Secretary of Labor, and I served as a consultant – George told me that would be a good appointment. I think it would have been a good appointment in spite of the fact that he was once an academician. Let met talk about accounting for a minute. I think that we all take it a bit too seriously. (Laughter) The only accounting lesson that I ever got that was worth a damn was from Robert Frost. He once said, if I remember it right, nobody was ever meant to remember or invent what he did with every cent. (Applause) I'm sure that answers the question.

LEE SEIDLER: The recent development, if I can continue a bit with accounting after that, the Moss Committee recently commended the SEC as the best of a group of independent regulatory agencies it studied. And it also recommended that the SEC as soon as possible take over the function of setting uniform accounting principles and auditing standards. I'm sure you agree with their assessment of the SEC. Do you agree with their suggestion that the Commission should set uniform accounting and auditing standards? And do you expect it to do so?

THE HONORABLE RODERICK M. HILLS: Categorically no. (Applause)

ROBERT HOTZ: General Haig, you mentioned earlier the broad spectrum of political problems facing the NATO Alliance. And I wonder if you could elaborate in a little more detail on two of the rather thorny ones facing you. First, what is the current role of France? Is it edging back into NATO? And secondly, how do you see the future role for a NATO country that acquires an active Communist element in the participation of its government?

GENERAL ALEXANDER M. HAIG, JR.: You know we have a very active club in Washington for the military called Foot in Mouth. (Laughter) And while it doesn't have an exclusive membership, I'm not about to join it tonight. (Laughter)

ROBERT HOTZ: Do you think General Brown covered those questions adequately? (Laughter)

Well, to get back to something perhaps more apropos, the Warsaw Pact countries have their military equipment standardized by edict because it's all supplied by the Soviet Union. And one of the great problems facing NATO today is the great proliferation of types of weapons ranging all the way from varying calibers of small arms ammunition up to different types of aircraft and complicated munitions. Do you see any progress in achieving a practical standardization of NATO weapons? And how do you think the best method of accomplishing this appears in the modern industrial military environment?

GENERAL ALEXANDER M. HAIG, JR.: Well, I have made the point repeatedly that standardization in its broadest sense involves two problems. One is that from the time of womb to boom, basically from my point of view, from my interest runs about ten years, from the time there's a decision for common procurement to the time we have the hardware on the ground. There's been a great deal of rhetoric about this subject in Western circles in the past two years. And in some respects, it's almost counter-productive because what is constantly emphasized is the tens of billions of dollars each year squandered by inefficient procurement systems and uncommon procurement. I would suggest that in an historic sense no alliance of sovereign nations has ever acquired the degree of standardization which we in NATO have already enjoyed today. And I'm not so sure the millennium would be desirable in the first instance when you consider that it is competition that drives the qualitative standards that the West has achieved. Now having said that, I want you to understand I'm highly in favor of standardization and urge daily those decisions designed to achieve it. But unfortunately, I do not have the luxury of waiting ten years in a strategic environment of the character which I described. Therefore, in the shorter term, what we have got to press for, through practical application of integrated performance by multinational formations on the ground, is interoperability. And that's the ability of our forces to work, fight, communicate, talk, think, strategize together. And that's the shorter term solution to the longer term problem. In this area we've made massive strides in the past year through an integrated exercise program, which this year for the first time in the history of the alliance found over a quarter of a million men, 1,600 aircraft, 400 ships, operating in multinational, multi-discipline formations from the northern tip of Norway to the southeastern

extremes of the Mediterranean. And in 29 separate exercises, all under a common scenario of Allied Commander, it's the first time in history that this alliance has done this. The dividends we have reaped in interoperability and long-term standardization consensus have been highly dramatic and I'm very encouraged by them. Have I answered your question? (Applause)

ROBERT HOTZ: Yes, indeed. Could I return to France just for a moment.

GENERAL ALEXANDER M. HAIG, JR.: I was flippant on France, and I'll answer your question. I always, on France, answer the question that within the parameters of the decision made by President de Gaulle in 1966, our military relationships with France are highly satisfactory. And to go beyond that, generally, could jeopardize the progress that we seek.

ROBERT HOTZ: Well, the French recently participated in the NATO Mediterranean maneuvers with their aircraft carrier, Clemenceau. Is this a departure, in a new direction, or has this been a standard procedure?

GENERAL ALEXANDER M. HAIG, JR.: Well, even with respect to that subject, France is not a member of the Integrated Military Command. It is a full partner in the political forums of the NATO Alliance itself. And as such, even a question to me about their participation in an exercise should be best be given to France.

LEE SEIDLER: Mr. Chairman, as you said, and as I think our audience appreciates, the SEC has been very active in the last year in the area of what might be called illegal and improper payments. But the type of payments or acts that have been covered, other than in the political area, have been principally found in the foreign area. I think the business community has absorbed, if it's not entirely pleased, the SEC's position on the area of foreign payments. However, recently the Commission seems to have concluded its first major case relative to domestic acts. I refer to the Emerson's case which is a restaurant chain, which a principal accusation appeared to be that officers of the restaurant chain took payments which were made by three major brewers to urge the restaurant chain to use their brands of beer. And when I say they took the payments, my understanding of the consent decree seems to be that the Commission was admonishing mainly the fact that they literally took the payments. That is, that the payments did not go through the corporation, but that offices of the company directly took payments. And as I read the consent decree, it appeared to me that had those, essentially, bribes to use certain beers gone into the company coffers, the company would not have been in trouble. Is that a correct interpretation?

THE HONORABLE RODERICK M. HILLS: No. But let me speak to that for a minute. First, the background. Companies that indulge in extracurricular payments for the purpose of diverting, getting business, or directing business, are not particularly engaged in foreign commerce or interstate commerce, almost without exception in the major cases – I'm not speaking about the areas of conflict about materiality, that's a different subject on which I'm perfectly at peace to

talk about but it doesn't come within your question – where you find a company that has indulged in what I would label the gross bribe abroad in a slush fund separated from its corporate governance system, you don't find any greater reluctance in that same company to bribe here at home. Emerson's was involved in a case, in an industry where prices were fixed, if you don't mind me coming back to an earlier theme, where state laws told people what they could charge for a beverage. Some customers weren't content with paying the price that everybody else paid. Not content to pay that price, people who had control over the business decision of the source of their beverages found some way to evade the price restrictions. From what I know of the securities industries, the reciprocals and the give-ups were overwhelmingly at least open and honest and were for the benefit of the people that they represented. In other words, if a fund took a give-up or a reciprocal, for the most part, I at least hope and have no reason to doubt, for the most part, that the give-ups and the reciprocals, inappropriate under the regulation, were for the benefit of the stockholders. The allegations, and I should say very carefully that Emerson's and its officers did not admit the truth of the complaint, but the allegation was that individuals outside the corporation used their buying power to get personal benefit out of the fact that they had the power to direct their buying capacity to a given supplier. To me, it is no more complicated than an example of when you don't have free competition based upon buying power, based upon free market systems; you're likely to get aberrations that are illegal. Emerson's case, allegations, were only more severe because the monies that were gotten in return were for personal benefit rather than for the benefit of the Emerson's stockholders. I don't by any means suggest there wouldn't have been a case without it.

CHAIRMAN JAMES W. DAVANT: We have time for one more question each.

LEE SEIDLER: I'm trying to smoke you out. I'm trying to get a little better fix on the attitude the Commission will probably be taking in the future on domestic, as I say illegal and proper acts, and another thing that strikes interestingly the Emerson case is one of the payers was a publically held company, Schlitz, and I'm wondering why the Commission moved in this case to the recipient rather than the payor?

THE HONORABLE RODERICK M. HILLS: Well, we may be slow but we're never uncertain. (Laughter) I don't think you should derive anything from what you perceived. (Laughter) And let me just make a small commercial. It's a very hard area. We're never going to keep companies immune from extortion. We're never going to keep somebody from asking for a bribe they ought not to ask for, whether it's abroad or at home or any place else. We're never going to keep people from stealing. We're never going to keep people from lying. We're never going to keep people from taking bribes. What then can government expect to achieve from all of this so-called disclosure? To me, it's very simple. We can at least insist that publicly held companies put up the resistance that is logically to be expected to that kind of improper inducement. I can't tell you precisely how to draw the lines. I can't say to you that disclosure is an answer. I can tell you that in my judgment, to put upon the boards of directors and particularly the outside members of the boards of directors, not to say that many inside directors aren't the most, people of the greatest integrity, but as a system we need to create a resistance to that kind of inducement, a resistance

that is only expressed by outside directors who care about inquiring. When our corporations, if I can switch to a foreign country, go into a foreign country, are asked to do something illegal, to get business that they think they're legitimately entitled to, we should have the right not to, we should have the expectation in this country that our people will not use extortion as an excuse for bribery. And we should have the right to ask that the governing bodies of our corporation do everything in their power reasonably to resist that. If they do that, we can ask no more. There will be some bribes. There will be some extortion. There will be some nonsense. But if you look at the 22 cases the Commission has brought, and not at the flack we've created, you'll see we've only dealt with the gross abuses in the courts. And so when you come down to something like Emerson's and Schlitz or any other brewery, you must know as a moral certainty that there will be some nonsense going on because the economic power of the person buying is not reflected in the price he gets.

LEE SEIDLER: I wonder if in closing I could ask you a question and I've tried to figure out a tactful way to put it. I consulted with a former chairman of the SEC and he couldn't think of a tactful way. And that is, what is the position at the moment of a Republican-appointed Chairman of the SEC after Tuesday's election?

THE HONORABLE RODERICK M. HILLS: In doubt. (Laughter and Applause)

ROBERT HOTZ: General Haig, one short, sweet, and final one. Do you think that any useful



purpose would be served by reducing the American troop commitment in Europe, either military or economically?

GENERAL ALEXANDER M. HAIG, JR.: I have repeatedly taken the position that the current balance of forces in Western Europe are such that any reduction by any of our member nations I would be opposed to. It would inevitably force us to place greater reliance on nuclear response with all the unsatisfactory consequences that that entails. (Applause)

CHAIRMAN JAMES W. DAVANT: Thank you Mr. Hotz. Thank you Mr. Seidler. And once again, our thanks to you, General Haig, and to you Chairman Hills. To all of you, a cordial good night. The meeting is adjourned.