DOCUMENTS CROSS-REFERENCED

ATTACHED:

ER85-399

ER85-346

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EXECUTIVE SECRETARIAT
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Executive Secretary

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Date

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Executive Registry
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CABINET AFFAIRS STAFFING MEMORANDUM

Date: 2/20/85 **Number:** ---------- **Due By:**

Subject: Cabinet Council on Economic Affairs - Minutes

ALL CABINET MEMBERS	Action	FYI
ALL CABINET MEMBERS	☐	☑
Vice President	☐	☐
State	☐	☐
Treasury	☐	☐
Defense	☐	☐
Justice	☐	☐
Interior	☐	☐
Agriculture	☐	☐
Commerce	☐	☐
Labor	☐	☐
HHS	☐	☐
HUD	☐	☐
Transportation	☐	☐
Energy	☐	☐
Education	☐	☐
Counsellor	☐	☐
OMB	☐	☐
CIA	☐	☐
UN	☐	☐
USTR	☐	☐
Chief of Staff	☐	☐
GSA	☐	☐
EPA	☐	☐
NASA	☐	☐
OPM	☐	☐
VA	☐	☐
SBA	☐	☐

	Action	FYI
CEA	☐	☑
CEQ	☐	☐
OSTP	☐	☐
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Deaver	☐	☑
McFarlane	☐	☑
Svahn	☐	☑
Chew *(For WH Staffing)*	☑	☐
Chapman	☐	☑
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Executive Secretary for:		
CCCT	☐	☑
CCEA	☐	☑
CCFA	☐	☑
CCHR	☐	☑
CCLP	☐	☑
CCMA	☐	☑
CCNRE	☐	☑

REMARKS:

Attached for your information are the minutes of the following Cabinet Council on Economic Affairs meetings:

January 15, 1985
January 22, 1985
January 24, 1985
January 29, 1985

RETURN TO:

☐ Alfred H. Kingon
Cabinet Secretary
456-2823
(Ground Floor, West Wing)

☐ Don Clarey
☑ Tom Gibson
☐ Larry Herbolsheimer

Associate Director
Office of Cabinet Affairs
456-2800 (Room 129, OEOB)

DCI EXEC REG

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Sanitized Copy Approved for Release 2010/04/27 : CIA-RDP87M00539R002303820019-1

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

January 15, 1985
8:45 a.m.
Roosevelt Room

Attendees: Messrs. Block, Brock, Ford, Niskanen, Verstandig, Porter, Wallis, Jones, Burnley, Knapp, Poole, Healey, Naylor, Khedouri, Ginsburg, Ballentine, Breeden, Fitzwater, Gibson, Hall, Herbolsheimer, Li, McAllister, McMinn, and Shepherd, Ms. McLaughlin, and Ms. McCaffrey.

1. Report of the Working Group on Financial Institutions Reform

The Council continued its review of a study of the deposit insurance system prepared by the Working Group on Financial Institutions Reform. These reforms would adapt the deposit insurance system to changes that have occurred in financial markets and depository institutions since the 1930s when Federal deposit insurance was established. Mr. Porter stated that Secretary Regan, who was unable to attend the meeting because of an unexpected change in his schedule this morning, requested that the Council postpone final approval of the Working Group's recommendations until a subsequent meeting.

Assistant Secretary Healey recalled that during its previous meeting the Council considered the two most fundamental recommendations for reform, instituting variable risk-based insurance premiums and increasing capital requirements, both of which would be phased in over time. Mr. Healey reiterated that instituting a risk-related system would: 1) allow management to "choose" prospectively whether to pursue riskier strategies knowing that they will be assessed a higher deposit insurance premium; and 2) help disseminate information on the riskiness of insured depository institutions, mitigating the potential for "shocks" to the financial system that result from seemingly sudden failures.

He noted that, in addition to being a traditionally popular concept in theory, risk-related premiums were endorsed in reports on the deposit insurance system submitted to Congress by the FDIC and the FSLIC under the provisions of the Garn-St. Germain Act of 1982. In addition, a majority of the members of a panel of private and public sector financial experts informally advising the Working Group concluded that the Working Group's proposal could be implemented using public data already available from Federal regulators.

Mr. Healey then presented the remaining three recommendations: 1) improving accounting and disclosure; 2) increasing the size and flexibility of the FDIC and FSLIC funds; and 3) refining prudential supervision of insured institutions.

Improving Accounting and Disclosure

Mr. Healey explained that insured banks and thrifts use accounting standards in their quarterly financial statements that often do not present a clear picture of their financial status to regulators and the public. For example, regulatory accounting principles (RAP) used by S&Ls tend to overstate true net worth. He stated that the Working Group's recommendation would permit no new RAP regulations and phase out existing RAP regulations over time, substituting consistent generally accepted accounting principles (GAAP) in their place. In addition, the Working Group recommends requiring greater management accountability in the operations of insured institutions, including the disclosure of "material events" to regulators and the public. Mr. Healey noted that these reforms would not increase the paperwork required of depository institutions.

Increasing the Size and Flexibility of the Insurance Funds

Mr. Healey reported that there has never been a systematic review of the adequacy of the FDIC and FSLIC funds. Given economic changes and the apparent decline in the size of the FSLIC fund -- absolutely and as a percentage of assets held aggregately by S&Ls -- there is a genuine need to do so. The Working Group recommends that the Administration and Federal regulators review the relative size of the FDIC and FSLIC funds to determine the need for and urgency of increasing the funds. In addition, the Working Group recommends that the Administration work with the regulators to develop additional tools for handling failures in an equitable manner.

Refining Prudential Supervision of Insured Institutions

Mr. Healey explained that the extraordinary growth in the size of S&Ls, in particular, indicated to the Working Group that Federal regulators may not have sufficient staff and procedures to examine and identify effectively those institutions posing the greatest risk to the financial system. The Working Group recommends that the Administration work with the regulators to determine what additional resources are needed to encourage stability and reduce costs in the long term.

The Council's discussion focused on: net worth and changes in interest rates as indicators of institutions' financial condition; the liability of private auditors in bank failures; the negative true net worth of some insured institutions using regulatory accounting principles; the expiration this October of the "net worth certificate" program for S&Ls; and the possibility that increasing capital requirements to strengthen the stability of the system will lead to more concentrated banking and thrift industries.

2. Economic Conditions in the Agriculture Industry

Secretary Block and Under Secretary Naylor presented an update on financial conditions in the agriculture sector. There are potential increases in rural bank and farm failures in the next six months to two years, assuming economic conditions remain constant. Secretary Block noted that the intent of the update was to indicate the pressures due to farm credit conditions that may affect the deliberations on the 1985 Farm Bill.

The sharp devaluation of farmland which has occurred since 1981 has contributed heavily to the current farm credit problems. Declining land values and equipment equity have resulted in high debt to asset ratios for approximately 178,000 commercial-scale "family" farms (representing less than eight percent of all farms, but one fourth of commercial family-owned farms) concentrated in the Corn Belt, Lake States, and the Northern Plains.

Mr. Naylor suggested that the FmHA and the cooperative Farm Credit System will experience increased stress during the coming weeks. The first failure of a district regional (Spokane) Farm Credit Bank is expected to occur next week. The cooperative system appears capable of absorbing the Spokane failure and has not asked to use its Treasury borrowing authority. Mr. Naylor concluded that these problems raise the central issue of how the agribusiness industry will manage the necessary adjustment to declining farm values and how this process will affect the 1985 Farm Bill.

The Council's discussion focused on the origins of farm equity and credit problems and the likely pressures on the Federal Government to underwrite the inevitable "write-down" of farmland values. Mr. Porter stated that Secretary Regan asked the Working Group on Federal Credit Policy to study immediately the magnitude of the problem and assess its likely impact on the overall economy, and on the farm and banking sectors in particular.

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

January 22, 1985
8:45 a.m.
Roosevelt Room

Attendees: Messrs. Regan, Block, Niskanen, Porter, Wright, Wallis, Brown, Burnley, Sprinkel, Ballentine, Gibson, Haraf, Hawley, Herbolsheimer, Hull, Knapp, Platt, and Li, and Ms. McLaughlin.

1. <u>Financial Market Developments and Monetary Policy</u>

The Working Group on Financial Market Developments and Monetary Policy presented a report on investment patterns and 1985 money growth targets. Mr. Ballentine presented a paper reviewing recent domestic and foreign investment flows. Gross domestic fixed, especially nonresidential, investment has experienced unusually strong growth during the recent recovery and expansion. However, net domestic fixed investment, which equals gross domestic fixed investment less depreciation, has not grown as strongly because of the shift in investment to shorter-lived assets and commensurately higher depreciation. Real domestic fixed investment relative to Net National Product (NNP) has recovered only to its postwar average.

Moreover, much of the new investment in the U.S. is owned by foreigners. After adjusting net domestic fixed investment for foreign investment, U.S.-owned net investment relative to NNP has grown at the slowest rate since World War II.

The Council discussed the effects of the 1981 Economic Recovery Tax Act (ERTA) on gross, net, and foreign investment. Council members noted that ERTA provided a greater stimulus at the margin for investment than for savings. The corresponding foreign capital inflows contributed to the large trade deficits. The Council also discussed how economic data accounts for U.S. investment abroad as to whether it is financed by foreign debt or U.S. equity.

Mr. Sprinkel presented a paper reviewing recent financial and economic developments and the 1985 money growth targets. Interest rates have declined significantly. Short rates have fallen about 300 basis points since early September, while long rates have declined about 100 basis points.

Recent economic data suggest a strengthening of the economy in the months ahead.

Early next month, the Federal Open Market Committee (FOMC) will determine the 1985 money growth target ranges. There are several problems with the current method of target setting. First, if it follows past practice, the FOMC will base the 1985 target ranges on actual data for the fourth quarter of 1984. Given the slow growth of M1 since midyear, this practice will result in the base of the 1985 target cone being set artificially low.

Second, using target "cones" results in target ranges being narrow early in the year and wider toward the end, which risks greater volatility in money growth.

Mr. Sprinkel proposed two policy options to address these problems. First, the Federal Reserve could eliminate the problem of base-drift by anchoring the 1985 targets at the midpoint of the target range for the fourth quarter of 1984. Second, the target cone concept could be replaced with a band of plus or minus 1 percent around a single target rate of 5.5. percent. The Federal Reserve staff has indicated they believe this degree of accuracy is possible for M1 targeting.

The Council discussed the advantages and disadvantages of various widths of a target band. Council members noted that a wider band increases the risk of long periods of little or excessive money growth. On the other hand, a narrower band increases the risk that money growth may be outside the Federal Reserve's target range, which could increase market uncertainty.

The Council discussed the ability of the Federal Reserve to control money growth. Mr. Sprinkel noted that the Federal Reserve can control money growth or the federal funds rate, but not both simultaneously.

The Council agreed to recommend that the Administration in congressional testimony in February propose: 1) setting targets based on the midpoint of the target range of the prior year's fourth quarter; and 2) replacing the target cone with a target band without recommending a specific width. Instead, the testimony should present the arguments for and against a ±1 percent or ±1½ percent band.

The Chairman Pro Tempore requested the Working Group on Financial Market Developments and Monetary Policy to review what approaches the Federal Reserve could take to address perceived changes in velocity growth.

Council members discussed the need to develop a strategy for achieving a spending limitation-balanced budget constitutional amendment. The Chairman Pro Tempore requested that several options for a strategy be developed for Council consideration.

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

January 24, 1985
8:45 a.m.
Roosevelt Room

Attendees: Messrs. Regan, Block, Baldrige, Brock, Stockman, Niskanen, Svahn, Oglesby, Verstandig, Porter, Wright, Wallis, Burnley, Ballentine, Baroody, Breeden, Fitzwater, Gibson, Ginsburg, Herbolsheimer, Khedouri, Knapp, Lilly, Naylor, Niehenke, Spears, Li, and Ms. Risque.

1. Economic Impact of Farm Credit Conditions

Mr. Ballentine presented a report of the Federal Credit Policy Working Group on the current farm debt problem and various farm debt relief proposals. He reviewed the current Federal credit programs helping farmers, the major elements of the September 1984 initiative, the current status of farm debt, and the various farm debt relief proposals that have been or will be introduced in the Congress. He noted that much of the farm debt problem could be attributed to the natural response of the economy to correct for overinvestment in assets, which has taken place not only in the farm sector, but other sectors as well. The Administration faces two broad options: 1) to maintain the current policy by relying on the September initiative as announced; or 2) to attempt to devise a new policy initiative by amending the September program.

The Council discussed the causes of the rise in farm land values in the 1970's and the decline in land values in the 1980's. Although land values in general have declined from their 1981 values, they are still higher than their 1975 levels and they have increased at a faster rate over the 1975-1984 period than inflation. In addition, the government sector accounted for over 80 percent of the increase in farm real estate loans outstanding from 1975 to 1983.

Council members noted that the decline in farm land values since 1981 is a result of fundamental economic changes, in particular, a move from the high inflationary environment of the late 1970's to a lower inflation environment of the 1980's.

The Council reviewed specific elements of the September initiative, placing the initiative in the context of continuing Federal Government credit programs helping farmers. In addition, the Council discussed the potential impact of any expansion of farm credit programs on the overall budget situation.

Council members discussed the concentration of the farm debt problem in certain regions. The farm debt problem does not appear as serious in the Southeast because the Farmers Home Administration effectively controls the lending market there. The Council noted that much of the farm debt problem is in the Corn Belt, Lake States, and the Northern Plains.

The Council discussed what actions the States could take to address the problem. Council members noted that some farm States prohibit foreign or corporate investment in farm land, which reduces its liquidity and exacerbates the decline in land value.

The Chairman Pro Tempore asked that several task forces be established to develop solutions to the different aspects of the farm debt problem. The Council will review this issue again next week.

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

January 29, 1985
8:45 a.m.
Roosevelt Room

Attendees: The Vice President, Messrs. Regan, Block, Baldrige, Brock, Stockman, Ford, Niskanen, Svahn, Oglesby, Verstandig, Porter, Wright, Healey, Naylor, Baroody, Breeden, Donatelli, Gibson, Gingrich, Jones, Khedouri, Knapp, McMinn, Rhodes, Spears, Thompson, and Li, and Ms. Risque.

1. Economic Impact of Farm Credit Conditions

Mr. Healey presented a report on the impact of the farm debt problem on commercial banks. Agricultural banks are defined as those banks whose agricultural loans constitute 25 percent or more of total loans. Although agricultural banks account for about 30 percent of the total number of commercial banks, they account for only about 5.2 percent of all bank assets. Agricultural banks considered by the Federal Deposit Insurance Corporation to be problem banks constitute about 37 percent of all banks in the U.S, but only 2.2 percent of the roughly 14,000 insured banks in the U.S. Most of these problem agricultural banks are concentrated in six States: Iowa, Illinois, Kansas, Minnesota, Nebraska, and Missouri.

Agricultural banks generally are more highly capitalized than nonagricultural banks. While their greater capital better enables agricultural banks to handle loan losses, the potential for agricultural loan losses has increased and is expected to worsen. It was noted that although the condition of many agricultural banks is serious, the problems afflicting the savings and loan associations and energy lenders several years ago were greater in scope.

Mr. Healey also noted that the bank regulators are consistently treating banks with large agricultural portfolios. In addition, the seasonal borrowing facility at the Federal Reserve discount window is currently operating, although the scope of its use has remained relatively limited.

Mr. Naylor presented a paper outlining proposed revisions by the Working Group in Farm Credit Conditions in the September 1984 agricultural debt restructuring initiative.

Regulations for the September initiative were issued on an emergency basis subject to a 30-day comment period. There were two proposed changes in the program: 1) permitting lenders to grant interest rate concessions instead of writing down 10 percent of the principal; and 2) reducing the cash flow requirement by eliminating the 10 percent reserve.

One option is to maintain the reserve requirement, but to permit lenders the option of granting interest rate concessions as long as the following conditions were met: 1) the total Government guarantee exposure of any resulting restructured loan will remain the same as that provided under the initiative as announced in September; 2) the farm operator will receive sufficient reduction in the debt payment structure under the restructured loans to ensure a reasonable cash flow plus a 10 percent reserve during the term of the loan; 3) the financial institution applying for a Federal guarantee may not recover from the operator concessions in principal and/or interest payments granted as part of the terms of the loan restructuring; and 4) the present value of the interest rate reductions is equivalent to the value of the principal writedown.

The Council discussed the overall context of the farm debt problem and the appropriate role for the Federal Government, concluding that the Federal Government cannot and should not attempt to resist fundamental economic forces that are restructuring the farming and other sectors. However, Council members noted the importance of preventing the farm debt problem from damaging the prospects for enacting a market-oriented 1985 Farm Bill. Council members also noted that additional Federal credit guarantees could have an impact on the ability to restructure the price support system next year.

The Council discussed the likely demand for Federal guarantees if an interest writedown were allowed as an alternative to a principal writedown. Council members noted that the demand may increase significantly because of the increased attractiveness of an interest rate writedown to lenders. The Council also discussed whether the program directs funds toward the most needy borrowers.

The Cabinet Council will consider the issue further at its meeting on Thursday.

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Executive Secretary

28 January 85
Date

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THE WHITE HOUSE
WASHINGTON

CABINET AFFAIRS STAFFING MEMORANDUM

Date: 1/25/85 **Number:** 169124CA **Due By:**

Subject: Cabinet Council on Economic Affairs Planning Meeting - 1/29/85
8:45 A.M. - Roosevelt Room TOPICS: Farm Credit Conditions
Regional Impacts of the Recovery

	Action	FYI
ALL CABINET MEMBERS	☐	☐
Vice President	✓	☐
State	✓	☐
Treasury	✓	☐
Defense	✓	☐
Attorney General	☐	✓
Interior	☐	✓
Agriculture	✓	☐
Commerce	✓	☐
Labor	✓	☐
HHS	☐	✓
HUD	✓	☐
Transportation	✓	☐
Energy	☐	✓
Education	☐	✓
Counsellor	✓	☐
OMB	✓	☐
CIA	☐	✓
UN	☐	✓
USTR	✓	☐
GSA	☐	☐
EPA	☐	☐
NASA	☐	☐
OPM	☐	☐
VA	☐	☐
SBA	☐	☐

	Action	FYI
CEA	✓	☐
CEQ	☐	☐
OSTP	☐	☐
Baker	✓	☐
Deaver	☐	✓
Darman *(For WH Staffing)*	✓	☐
Mc Farlane	☐	✓
Svahn	✓	☐
Chapman	☐	✓
Executive Secretary for:		
CCCT	☐	☐
CCEA	✓	☐
CCFA	☐	☐
CCHR	☐	☐
CCLP	☐	☐
CCMA	☐	☐
CCNRE	☐	☐

REMARKS:

There will be a Cabinet Council on Economic Affairs Planning Meeting on Tuesday, January 29, 1985, at 8:45 A.M. in the Roosevelt Room.

The agenda and background paper for the second agenda item are attached.

RETURN TO:

☐ Craig L. Fuller
Assistant to the President
for Cabinet Affairs
456–2823 (White House)

☐ Don Clarey
✓ Tom Gibson
☐ Larry Herbolsheimer
Associate Director
Office of Cabinet Affairs

DCI EXEC REG

L-300B

THE WHITE HOUSE

WASHINGTON

January 25, 1985

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: ROGER B. PORTER RBP

SUBJECT: Agenda and Paper for the January 29 Meeting

The agenda and paper for the January 29 meeting of the Cabinet Council on Economic Affairs are attached. The meeting is scheduled for 8:45 a.m. in the Roosevelt Room.

The Council is scheduled to consider two agenda items: economic impact of farm credit conditions and regional impacts of the recovery. The Council will continue its review from the January 24 meeting of the economic impact of farm credit conditions. No papers will be circulated in advance of the meeting.

The Council will also consider the regional impacts of the recovery. A paper from Sidney Jones reviewing this issue is attached. The paper examines differences in the recent economic performance of the various regions in the U.S.

Attachments

EXECUTIVE SECRETARIAT

ROUTING SLIP

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8	DDS&T				
9	Chm/NIC				
10	GC				
11	IG				
12	Compt				
13	D/Pers				
14	D/OLL				
15	D/PAO				
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SUSPENSE ______________
Date

Remarks

STAT

[redacted]

Executive Secretary

23 Jan 84

Date

3637 (10-81)

THE WHITE HOUSE
WASHINGTON

Executive Registry
85- 346

CABINET AFFAIRS STAFFING MEMORANDUM

Date: 1/22/85 **Number:** 169122CA **Due By:**

Subject: Cabinet Council on Economic Affairs Planning Meeting - January 24, 1985
8:45 A.M. - Roosevelt Room TOPICS: Rpt of Working Group on Corp. Takeovers; Economic Impact of Farm Credit Cond.

	Action	FYI
ALL CABINET MEMBERS	☐	☐
Vice President	☑	☐
State	☑	☐
Treasury	☑	☐
Defense	☑	☐
Attorney General	☐	☑
Interior	☐	☑
Agriculture	☑	☐
Commerce	☑	☐
Labor	☑	☐
HHS	☐	☑
HUD	☑	☐
Transportation	☑	☐
Energy	☐	☑
Education	☐	☑
Counsellor	☑	☐
OMB	☑	☐
CIA	☐	☑
UN	☐	☑
USTR	☑	☐
GSA	☐	☐
EPA	☐	☐
NASA	☐	☐
OPM	☐	☐
VA	☐	☐
SBA	☐	☐

	Action	FYI
CEA	☑	☐
CEQ	☐	☐
OSTP	☐	☐
Baker	☑	☐
Deaver	☐	☑
Darman *(For WH Staffing)*	☑	☐
Mc Farlane	☐	☑
Svahn	☑	☐
Chapman	☐	☑
Executive Secretary for:		
CCCT	☐	☐
CCEA	☑	☐
CCFA	☐	☐
CCHR	☐	☐
CCLP	☐	☐
CCMA	☐	☐
CCNRE	☐	☐

REMARKS:

There will be a Cabinet Council on Economic Affairs Planning Meeting on Thursday, January 24, 1985, at 8:45 A.M. in the Roosevelt Room.

The agenda and background papers are attached.

RETURN TO:

☐ Craig L. Fuller
Assistant to the President
for Cabinet Affairs
456-2823 (White House)

☐ Don Clarey ☑ Tom Gibson ☐ Larry Herbolsheimer
Associate Director
Office of Cabinet Affairs
456-2800 (Room 129, OEOB)

L-300B

THE WHITE HOUSE

WASHINGTON

January 22, 1985

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: ROGER B. PORTER RBP

SUBJECT: Agenda and Paper for the January 24 Meeting.

The agenda and paper for the January 24 meeting of the Cabinet Council on Economic Affairs are attached. The meeting is scheduled for 8:45 a.m. in the Roosevelt Room.

The Council is scheduled to consider two agenda items: corporate takeovers and the economic impact of farm credit conditions. The Council last considered corporate takeovers at its meeting on July 24, 1984, when it established an interagency working group to determine the extent of the problem of abuses in tender offers and what approach would best address potential abuses. The Working Group has held a number of meetings examining the data and developing an Administration position on possible corporate takeover legislation. A paper from Doug Ginsburg, chairman of the Working Group on Corporate Takeovers, is attached.

The second agenda item is the economic impact of farm credit conditions. A paper on this agenda item will be circulated tomorrow.

Attachments

THE WHITE HOUSE

WASHINGTON

CABINET COUNCIL ON ECONOMIC AFFAIRS

January 24, 1985

8:45 a.m.

Roosevelt Room

AGENDA

1. Report of the Working Group on Corporate Takeovers (CM # 481)

2. Economic Impact of Farm Credit Conditions (CM # 514)

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

JAN 22 1985

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: Douglas H. Ginsburg D. Ginsburg
Adminstrator for Information and Regulatory Affairs

SUBJECT: Corporate Takeovers

The Working Group on Corporate Takeover Legislation has drafted a proposed Administration position for the CCEA's consideration. We anticipate that corporate takeovers will receive early attention in the Congress, and that the Administration will want to be ready to present its views. The proposed position is attached to this memorandum; an annotated version is at Tab A. This proposed position was developed and reviewed by representatives of the Departments of the Treasury, Justice, Commerce, and Labor, the Vice President's Office, the Council of Economic Advisers, the Office of Policy Development, and the Office of Management and Budget.

The Cabinet Council established this working group last July to consider the advisability of Federal legislation then being proposed in both the House and Senate to regulate corporate behavior during takeover attempts. On September 25, Secretary Regan sent a letter to Chairman Dingell opposing H.R. 5693 (Tab B). On October 2, Thomas Healey opposed new legislation in a statement to the Senate Banking Committee (Tab C). Both documents were circulated to the Working Group in draft form and the proposed Administration position reflects much of what has already been said in those documents. None of the bills we opposed was enacted last year, although H.R. 5693 was reported out of the Committee on Energy and Commerce, and two of its provisions were attached to the banking bill that passed the Senate.

Both Senator D'Amato and Congressman Wirth intend to hold extensive hearings on corporate takeovers this year. Senator D'Amato's subcommittee plans to begin in February. Congressman Wirth may begin hearings by late February. Both chairmen expect to focus on "broader" issues surrounding takeovers -- such as whether takeovers are good for the economy and whether the business judgment rule is adequate to deal with takeovers -- in addition to relatively specific proposals, such as greenmail and golden parachutes.

Having reviewed the analytical and empirical evidence relating to these issues, the Working Group proposes that the Administration continue to oppose any Federal legislation dealing with corporate takeovers. We should look first to competitive markets and second to the traditional role of the States in corporate governance to deal with such problems as do arise. Federal legislation should be a last resort, used only if the markets and State law fail to deal with these problems.

Our fundamental conclusion is that there is no compelling evidence of such a failure and, as a result, new Federal legislation is both unnecessary and unwise. On the contrary, although some questions have yet to be answered, the evidence that does exist indicates that our historic reliance on the markets, State law, and the courts to deal with problems of corporate governance continues to serve the country very well.

Attached are several key documents. We commend especially to your attention the draft Chapter 6 of the 1985 Economic Report of the President (Tab D), for an overview of the subject matter. The recent Harvard Business Review article by Micheal Jensen (Tab E) is a shorter overview in a journalistic style. Also included for more background are:

- Tab F -- "The Market for Corporate Control: The Scientific Evidence," by Michael Jensen and Richard Ruback. This survey of the scientific literature indicates that corporate takeovers generate significant positive gains and that those gains do not come from the creation of market power. The article also summarizes the evidence regarding specific practices.

- Tab G -- "Do Targets Gain From Defeating Tender Offers?" by Frank Easterbrook and Gregg Jarrell (Easterbrook was recently nominated by the President to the Seventh Circuit Court of Appeals; Jarrell is currently the SEC's Chief Economist). This recent study concludes that successful defensive tactics by management have deprived shareholders of gains between 15 and 52% of the value of their shares and that the stock prices of firms that defeat offers and remain independent do not recover.

- Tab H -- "Do Acquirers Benefit From Corporate Acquisitions?" by Gregg Jarrell. This technical paper, which will be published shortly, demonstrates that acquiring firms' shareholders (not just target shareholders) also receive substantial gains as a result of mergers and takeovers.

- Tab I -- Norlin Corporation v. Rooney, Pace Inc., et.al., (2d Cir. 1984). This significant new decision holds that a board of directors may, under the business judgment rule, oppose an acquisition if it decides that opposing the acquisition is in the interests of the company and shareholders. However, the duty of loyalty requires the board to demonstrate that any actions it takes are fair and reasonable.

Attachments

PROPOSED ADMINISTRATION POSITION
CORPORATE TAKEOVERS

I. Corporate takeovers perform several beneficial functions and are generally good for the economy.

II. The Williams Act represents a compromise between the desire to afford target shareholders and managements a reasonable period of time in which to evaluate offers, and the needs of the competitive markets in securities and in corporate control to operate with a minimum of government regulatory interference. We have seen no evidence that the existing provisions of the Williams Act are insufficient to achieve their purpose.

III. Various limitations on bidder activities have been proposed, but no need for additional restrictions on bidders has yet been demonstrated.

IV. Target company shareholders need and have protection from abuses by target managements in conjunction with contests for corporate control.

V. State law, enforceable in the courts, governs the permissible terms of corporate charters, management contracts, and managers' and directors' fiduciary obligations, each of which may be used to prevent management abuses.

VI. Unless there is compelling evidence of a serious market failure of national dimensions, unchecked by the states or the courts, the Federal Government should take no step towards the establishment of Federal corporation law to govern relationships between shareholders and managers.

VII. While matters of corporation law have properly been the subject of state rather than Federal jurisdiction, the Federal Government should play an informational role by making public the best information about critical issues that shareholders are likely to face in corporate change of control contests.

VIII. The Federal Government should also carefully consider the unintended effects that other Federal policy decisions may have on merger and acquisition activity. To the extent that these Federal decisions encourage more or less merger and acquisition activity than otherwise would have taken place in a free market, resources may be misallocated.

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