ADDRESS
OF

GANSON PURCELL

Chairman, Securities and Exchange Commission

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I have chosen to talk about subjects of paramount present-day interest and importance, the securities and capital markets in the post-war period and the prospects for domestic and foreign financing. The State and Federal regulatory authorities gathered here are charged by law with constant responsibility for the improvement and maintenance of the standards of conduct in these markets, to the end that public confidence in their safety as a place to deal may be assured and justified. It is the vital concern -- or should be, if it is not-- of all peace loving people, that world reconstruction should proceed without delay. That reconstruction must be financed -- financed through the wise expenditure of capital, most of which is available only here in the United States. Under a full employment economy we can also look forward to a substantial volume of domestic investment. The needs for this financing, the methods by which it is to be obtained, and the manner in which a sound financial mechanism can affect and protect it, I hope to develop to the extent that this brief talk will permit.

First, let us review for a moment some of the current factors in our securities markets and our financial economy. The most casual student will see, almost at a glance, that great changes have been brought about in the last few years, first through legislative and administrative governmental reform, and, more latterly, as the result of the devastating pressures and dislocations of the total war through which the world has just passed.

The passage of the Federal securities legislation and its administration, the improvement of State laws and the constant strengthening of their enforcement, the combined effects of these steps on the health and vigor of our financial economy, are well-known to us all. We may all be justly proud of the extent to which fraud has been suppressed, corporate economic information disseminated and the general standards of business ethics raised, without at the same time injecting into our financial freedom authoritarian powers of control over individual choice and action. We have not, however, reached this point over night; nor would I contend that we have achieved the perfect state.

Let me survey the various stages of the operation of our financial markets during the period of the past war. Not long after the outbreak of hostilities in Europe in the latter part of 1939 you will recall that securities trading in our markets experienced a rather considerable decline which continued downward and remained at an extremely quiet level until the late part of 1942. Public offerings for industrial and other financing were also quite low with a moderate and fairly steady amount of public utility financing occasioned by companies which were going through the early stages of compliance with the Public Utility Holding Company Act of 1935, together with a modest sprinkling of industrial offerings, most of which, like the utility issues, were in the nature of refundings.

Even prior to the entry of the United States into the war after Pearl Harbor, a large part of the attention and energies of the people of this country were focused and concentrated on the tremendous effort which was made to convert and expand our industries for the production of war materials. At that time the great demand for munitions came from the nations which were defending themselves against the then mighty German war machine. While this program had of necessity to be financed, it obtained its funds not from the private capital markets but from Governmental sources established for the purpose. Investment in a war machine, or even in a munitions industry manufacturing war materials for export, is not, as we all know, a widely attractive medium for private capital -- nor is it an appropriate one for the general run of investors, individual or institutional. In addition, the amount of funds which can be obtained from such sources and the cost of such money is too uncertain to permit risking the success of such a vital undertaking.

The lack of response of our private capital markets to the substantial increase in activity during this early period was largely occasioned by the resort to Government financing. Furthermore, when the United States declared war and joined with its allies in active hostilities against the Axis powers, the trend away from private financial transactions was very much intensified.

There were many at that time who, because of these conditions, felt that our whole private financial system was in a precarious position. Some, indeed, looked on these as certain signs of the collapse of that system and its institutions. It is to the great credit of the men of vision and courage who stood by and saw this great industry through its lean years that such a collapse was averted.

I appreciate that it may be unbecoming in me to herald the arrival of a new era of finance under the administration of the Federal securities laws. I do feel, however, that at the very least the contribution of this legislation to the successful survival of our financial economy must be pointed out. Much of the story has been told before, but I think it will bear repetition. The administration of the Securities Act of 1933 and the Securities Exchange Act of 1934 had been underway for four or five years before the first rumblings of war in Europe were heard. During that time the organization and practices of our principal securities exchanges had undergone thorough examination and review and such changes under authority of law had been made as appeared to be desirable or necessary in bringing about sound conditions in those markets in which the public had been encouraged to trade. When war finally came with the invasion of Poland in September 1939, there was no panic, although the exchanges and the Securities and Exchange Commission were prepared for it -- if it should come. The exchanges did not close as they had at the beginning of the first world war in 1914. To whatever specific causes it may be due -- whether an absence of manipulated price structures, a restriction on the volume of credit in the market, or whatever -- there was no great distress selling and the blow was absorbed without real event. This experience repeated itself at the fall of France, the debacle of the Balkans, the invasion of Russia, the whole inundation of the European continent, the near fall of Britain itself and finally, Pearl Harbor. Most of us have come to recognize that this performance under such adverse conditions was proof of the essential stability which had been created in our markets.

And if that were not proof enough, it is well to call to mind the events which have taken place since the low period of 1942. There has been a notable revival of interest in our securities and capital markets. Prices and activity on the exchanges and in the over-the-counter markets have steadily increased and public offerings of securities of private enterprise have been made and absorbed in greater amount.

But here let me sound a note of warning. Up to a very recent date, I think our markets have reflected basic conditions generally in our industry and the widely held view of the outlook for the future. It has, however, been suggested -- and I think not without reason -- that they also reflect an anticipated acceleration in the inflationary trend which was so successfully held within limits during the years of conflict. If this is true we should take care to see to it that it does not continue while our faces are turned the other way.

I recognize, of course, that certain controls exercised in actual wartime must be lifted or readjusted in order to ease the way back through the reconversion process into peacetime activities, But we must not let ourselves take precipitate action. Inflation must be prevented through such controls as are necessary for the purpose in order that our economy may not burst at the seams. To permit inflation to take place in the United States of America at this particular juncture in the world's history would be disastrous. It would increase enormously our reconversion problems and make more difficult the attainment of world reconstruction.

It is gratifying to look back over the war years and see just how well those engaged in all walks of business during that hectic period have been able to hold together and even strengthen their organizations when it was most difficult to do so. Some of us who had occasion to discuss on the threshold of our war activity the difficulties which undoubtedly would beset our financial and business organizations laid great stress on the importance of creating during the war sound financial structures and practices capable of withstanding the shocks of the reconstruction period. I expressed my own view in the fall of 1941 on one or two occasions, that if we could succeed in this our securities markets would be able to perform a very important service in post-war finance. We have succeeded, in my opinion, and we must turn to and tackle the job now that we are face to face with it.

What is the outline of this task; what are its principal problems; is it concerned with the domestic or the international field -- or both?

Let us turn first to the prospects for domestic financing. Apart from refunding operations, the volume of new issues of American corporations in the post-war period will depend almost entirely on the level of industrial production. Only if a very high level of national income is achieved will any significant amount of new issues be required to take care of additional capital investments and working capital.

During the war there was comparatively little net private investment in plant and equipment in spite of the unprecedented level of business activity. The reason of course is obvious. For War industries, the necessary new plant and equipment was financed directly by the Government;

for non-war industries, priorities, allocations, etc. effectively prevented any capital expansion. Where corporations needed increased working capital, this was amply provided by retained profits, depreciation charges in excess of replacement expenditures, larger Federal income tax reserves, V loans, and advances and prepayments by the U. S. Government.

While there was over the war years a substantial volume of corporate financing in the capital markets, amounting to nearly $8 billion from the end of 1941 to the middle of 1945, most of it was for purposes of refunding. Companies in all fields have been taking advantage of the low money rates to reduce their interest charges and to extend their bond maturities, at the same time availing themselves of the privilege afforded by the corporate tax laws to charge off to tax liabilities any premium paid on bonds redeemed. In addition to refunding operations, there were substantial amounts of outright redemptions of corporate bonds. Thus in the period since our entry into the war, retirements of corporate securities exceeded issues by close to $1 billion.

As an aftermath of the War, American corporations taken as a whole have such a substantial reserve of liquid assets and such high net working capital that they could undertake considerable expansion from any previous level of peacetime activity without any very significant recourse to the capital markets. This extremely favorable financial position of corporations resulting primarily from the high level of retained profits has been discussed at some length in our quarterly releases on this subject.

Data collected by the Commission as well as by other Government agencies also show that though there was considerable variation for various industrial and size groups of corporations, practically all shared in the rise of working capital over the war period and were in a much stronger financial position at the end of the war than at the beginning. These studies indicate that small firms fared at least as well as the larger companies.

However, in spite of the favorable financial condition of corporations as a whole, there will undoubtedly be a number of individual corporations which will not be in so advantageous a position. There will be other corporations, existing as well as new enterprises, which will need additional capital for purposes of expansion. Finally, it is obvious that the financial position of all corporations will be affected by developments in the post-war period, particularly in the price level.

Several nationwide surveys have been carried out to determine what the actual capital needs for industry will be in the reconversion and transition period. Recent field studies by the Federal Reserve banks in conjunction with the Committee for Economic Development, covering several of the more highly industrialized regions in the country, suggest that actual reconversion costs will be quite small. Businessmen covered in these surveys do not feel that there will be any problem in financing reconversion internally.

Another study by the Department of Commerce, covering planned capital outlays and financial requirements during the 12 months following the end of the war in Europe, indicates that though planned outlays are fairly high, the financial requirements for funds to be secured from other than corporate resources are comparatively small.

It is extremely difficult to forecast the long-run level of capital expenditures in the post-war period and even more difficult to estimate the volume of capital issues. So far as capital expenditures are concerned, the Commission now receives from most registered corporations quarterly data on actual plant and equipment outlays and anticipated outlays for the next two quarters. On the basis of this information we are able to estimate for the first time capital expenditures for corporations as a whole on a current basis with a reasonable degree of accuracy. The importance of such data for the economy as a whole as well as the capital markets is self evident. Our first release on this subject appearing in a few days will show that though private capital expenditures for American companies in 1945 will not differ greatly from 1944, which was a relatively low year, there was a steady rise in the rate of such expenditures over the year, with quarterly expenditures in the fourth quarter of 1945 likely to be approximately twice as high as in the first quarter. We hope that in future reports we can indicate the extent to which companies will rely on the capital markets to finance such anticipated expenditures.

One development is almost certain. Only with the high level of production accompanying full employment or at least approximately full utilization of our resources will there be any very substantial recourse to the capital markets. There will certainly be no dearth of available funds for the capital markets, with the exception possibly of small company issues. Given the huge accumulations of liquid assets by individuals, institutions, and corporations, it seems quite clear that for the foreseeable future there will be an insufficiency of new security offerings to absorb the funds seeking investment outlets. Such funds will be needed and raised only if the level of activity is far greater than ever before in our peacetime history. This does not imply that we are now in a mature economy with our capital markets facing stagnation. It does imply that the activity and health of our capital markets as well as and possibly even more than most other sectors of our economy will depend on a level of post-war national income beyond anything we have experienced before the present war. The relationships, however, are not one-sided. Arrangements in the capital markets affect as well as are affected by the level of business activity and we must insure that they make their full contribution to the best functioning of our economy.

Let me give just one illustration of the problems facing the capital markets in this connection. So far as the overwhelming majority of large established businesses are concerned, it is probably safe to say that any deterrents there may be to obtaining funds for expansion lie outside the organization of the capital markets. However, this is not true for new, small and medium sized firms, a group which may well be able to use profitably and with benefit to the whole economy at large amount of new capital which they are not able to obtain from the capital markets as presently constituted.

Information gathered over the past few years has indicated the extreme difficulty small business finds in obtaining loan financing at reasonable rates, a striking contrast to the very low interest rates paid by large companies. The available material also indicates the virtual impossibility of obtaining equity financing as a result of the organization of the investment banking machinery which does not and, as presently constituted, possibly cannot handle small issues.

There have already been several attempts to make capital available, almost entirely in the form of loan financing, to small and, to some extent, to new business. These have been set up at interest rates which would not be so exorbitant from the viewpoint of the small business, but would at the same time permit a fair return or at least not involve a net loss to the institution advancing the loan. Such attempts, unfortunately, have not been particularly successful. Lending institutions both public and private have not advanced any considerable amounts of needed capital to small business even where empowered to do so under existing legislation. This may reflect to some extent an excessive conservatism of the banking fraternity, possibly induced in part by credit standards set up by public authorities. However, another very important factor tending to discourage a wider granting of loans has been the extremely risky nature of such commitments. Lending institutions were in the unenviable position of sharing in business gains only to the extent of interest charges, but sharing completely in any losses which might wipe out their entire capital investments. It is not entirely surprising that such institutions were sparing in their loan commitments to small business.

Most of the current plans including congressional bills now under consideration, for providing capital to small business propose to accomplish this end by a government guarantee though there is of course considerable variation in the particular institutional arrangements advocated. For the most part the proposed legislation stresses loan rather than equity financing. Unfortunately, there has been far too little objective evaluation of the necessity for or desirability of government participation or of the relative needs for or advantages of loan and equity financing. Some of the dangers of loan financing except in the most stable methods of businesses and economic conditions are too well known to need repetition here. In addition, I think there is some reason for believing that equity financing may be more profitable or at least less costly to the financing institution. Such considerations of cost are of obvious importance to the government if it is to engage in any substantial program of guaranteeing capital advances to small business and should be thoroughly investigated. On the other hand, even if equity capital is preferable from the viewpoint of the overall economy, there is considerable question as to the attitude of the individual entrepreneurs to this type of financing, i. e., the extent to which small business will be willing to have outside capital enter on a partnership rather than creditor basis.

This whole subject of providing needed capital to small business is, I think, timely, and potentially quite fruitful; it is not simply an intellectual exercise. The problem, however, is admittedly a messy one and has acquired an unfortunate emotional tinge over the course of years. The professional advocates of small business claim that a solution of this problem is the solution to our economic ills. On the other hand, some of our more skeptical economists deny that the problem is a real one. It seems to me that the truth, as usual, lies somewhere in between the extremes and that this sphere of activity may provide a fairly important outlet for new investment. Even if the final solution of this problem requires government subsidies, something which some of the proponents of aid to small business claim will not be necessary, this approach might conceivably provide a greater dollar for dollar stimulus to our economy than other types of government spending.

In my opinion there is room for further research in filling the more important gaps still remaining in the information neceesary for establishing new machinery for financing small business -- for instance, obtaining through a stratified sample quantitative data on the total amount and characteristics of the demand for financing by small business. Personally, I feel that some form of investment company offers a promising vehicle, but this is simply one of a great many possible devices.

Before leaving this subject I should like to point out that there is not much basis to the claim that the registration costs of floating an issue of securities under the Securities Act of 1933 is a deterrent to financing by small business. Thus, a survey recently made by the Securities and Exchange Commission shows that the total average cost of flotation of equity securities issued by the small companies under our jurisdiction is 21.6% of the anticipated gross proceeds to the company. Of this amount the compensation of investment bankers alone amounts to 19.7%. On the other hand, all other expenses in any way affected by registration, including such costs as printing, legal, accounting, engineering and miscellaneous expenses (which would be encountered to a very large extent regardless of registration) aggregate only 1.9% of these proceeds. The experience of the larger companies with respect to these expenses affected by registration is not too much different. Furthermore, it should be noted that the Commission's regulations exempt from the registration requirements any offering of new securities totaling $300,000 or less.

To sum up, there seem to be definite limits to the prospects for new domestic financing in the near future, particularly if we do not attain full employment of our physical resources. We are presented, however, in the field of foreign investment with quite a different set of factors. We are recognizing more clearly every day to what extent the rest of the world is looking to the United States for its financing. Not only are the countries in need of reconstruction seeking loans in our markets and from our government institutions, but also many foreign governments and private enterprises abroad which have plans for industrial expansion look to the United States' markets for their best and virtually their only source of credit. Our position today is not unlike that of England following the Napoleonic wars of the early nineteenth century. At that time the English bankers and investment public were practically the only source for rehabilitation and reconstruction of a war-torn Europe. The manner in which the British succeeded is now familiar history, and it is notable that in achieving these objectives the whole international economy was so stimulated that undreamed of levels in foreign trade and commerce were shortly achieved. Not least among these collateral results was the development and industrialization of our own country.

Our present financial position is considerably different from that in the period following World War I. The world at that time still looked upon the British as the world banker. Today, however, there is no ambiguity in the situation. England herself is an applicant for financial accommodations from the United States to a very substantial sum. There are other potential sources of credit outside of this country such as Canada, Sweden and Switzerland, but it may be frankly admitted that the exportable capital from these sources is inconsiderable relative to the demands of other nations.

There have been of late a number of estimates as to the anticipated magnitude of the foreign trade of the United States during the next decade. One of these current estimates for instance contains a recommended foreign trade budget for a typical post-war year which has as its principal components merchandise exports of ten billion dollars, merchandise imports of six billion dollars, giving an excess of receipts on merchandise trade of four billion dollars. To offset this, the budget foresees an excess of payments on service transactions of about three hundred million dollars and of primary importance an annual net outflow of capital consisting of between three and four billion dollars, of which at least three billion would consist of long-term capital investment. Indeed, the entire estimate is based upon the premise of capital exports of these magnitudes for a sustained period of time.

This type of analysis would seem to indicate that foreign investment by the United States is a matter of deep concern to all countries and peoples, including ourselves. Without a substantial and sustained export of capital it would seem clear that in the near future we could not expect to enjoy for any extended period a volume of merchandise exports anywhere approaching the level which ordinarily would accompany the high gross national product we are hoping for in the post-war period. Furthermore, it may even be contended that without the sustained export of capital by which high levels of foreign trade are generated and sustained, the achievement of a full employment economy in the United States would become more difficult. There is, I realize, considerable difference of opinion among experts as to the importance of foreign trade for prosperity within the United States but I think that it is generally agreed that a high level of foreign trade and a program of substantial capital export properly administered would at least facilitate the maintenance of a high level of domestic production.

The amount of United States capital which might be employed can be viewed either from the demand side or from the supply side. Taken from the former, the amount of funds which could be employed abroad in the next decade is of fantastic magnitude. We know, for example, that England has been negotiating for accommodations of three to five billion dollars; that Premier Stalin mentioned a figure of six billion dollars to a delegation of United States congressmen recently; and that France, the Netherlands and a number of other European countries have actually filed application for substantial amounts. Eastward, we know that China hopes to find the United States as helpful in her reconstruction and development as in her war effort. We have also been reading of plans for expansion and industrialization emanating from India, which looks to us as well as to the mother country for financial assistance.

On the supply side, there are several known factors and many unknown. Among the known factors are the recently extended lending facilities of the Export-Import Bank. By recent enactment Congress authorized this Bank to make loans for the promotion of our export and import trade up to the extent of three and one-half billion dollars. The Export-Import Bank has already acted under this authority and has either concluded or has in contemplation some rather substantial loans. It was not expected, however, that this Bank alone would be able to handle the volume of credits that would be sought. Besides the Export-Import Bank the International Bank for Reconstruction and Development, which is one of the two institutions covered by the Bretton Woods Agreement, will be an important organization in the field of international investment for many years to come. The International Bank will have a lending power of about nine billion dollars when all the signatory nations have accepted the agreement. The lending power of the International Bank, however, will, for the most part, depend upon the disposition of private investors to buy bonds of foreign governments or to buy the bonds guaranteed by foreign governments through the Bank itself. Unlike the Export-Import Bank, therefore, the International Bank will employ for the most part the funds of investors and not public funds raised by taxation or otherwise.

A question which is of utmost importance for the success of any foreign investment program by the United States relates to when and how American investors will be inclined to buy foreign securities or the bonds of an international institution. The problem is most acute for the substantial volume of foreign issues which will probably be needed outside the framework of the International Bank and without any such guarantees. It may be expected on the one hand that, because of the experience in foreign investment which followed World War I, investors in this country will be hesitant to buy issues of foreign origin. Furthermore, political stability would seem to be an essential pre-condition for confidence on the part of public investors. On the other hand, the liquid position of American investors, institutional as well as individual, would seem to encourage a rather more optimistic view. For some years, this Commission has reported at regular quarterly intervals upon the volume and composition of saving by individuals in the United States and upon the working capital of United States corporations and its components. The magnitude of these savings by individuals and the volume of assets held by corporations in highly liquid forms has been frequently commented upon. From this combination of circumstances in conjunction with the prospective requirements for new financing by United States corporations there would presently appear to be an excess of available funds over investment outlets in the domestic scene.

To date, there have been no important foreign long-term loans or investments made by the public. The American public has not as yet been called upon to evaluate foreign issues, and therefore it may be well at this time to ask what the average American will want to know, and what protections he will ask for in facing the prospect of investment of his savings in foreign governments and for foreign business projects.

Certainly one of the most valuable protections which has been afforded to the American investor since the previous era of foreign lending is the information made available to him under the provisions of the Securities Acts. Since the enactment of the Securities Act of 1933, which covers new issues, there have been practically no new issues of foreign securities. However, there are registered with the Commission under the Securities Exchange Act of 1934 practically all important issues of foreign origin sold in this country which were outstanding on the effective date of that Act.

New foreign government issues will come under the registration requirements of the Securities Act of 1933. Schedule B in that Act sets forth the data and information required in connection with such new issues. It is not unlikely that foreign governments will wish to have their securities admitted to dealings on a national securities exchange and will therefore undertake to file annual reports as required by the Commission under the Securities Exchange Act of 1934. Securities offered by foreign private enterprises will, of course, be subject to the same registration requirements as those of domestic firms. Through the medium of the Securities Acts, therefore, there will be made available to the American public far more information relative to foreign investments than it was accustomed to expect prior to the enactment of these statutes. Whether the provision of such information alone will give the full measure of protection to American investors which they will require or which should be afforded to them on their foreign securities is another question.

We in the Commission have, through years of administering our Securities Acts, learned to respect the importance and value of full disclosure of information as a means of protection to public investors in securities. It must be admitted, however, that there are problems to be faced in connection with the flotation of foreign securities in addition and beyond those which emerge in the course of domestic financing. These raise questions of importance to the State governments as well as to the Federal governments. The irresponsible and undirected foreign lending that followed World War I had serious repercussions within State borders, resulting in some instances in the collapse of financial institutions with losses to many policy holders and depositors.

The political picture is one of the most important problems. It has been suggested that it is one where disclosure may have to be supplemented by administrative action by some Government agency. Also of utmost importance are the economic ramifications which arise from the intricacies of foreign trade and commercial relations. How much and how closely these factors should be disclosed to public investors in foreign and international securities are questions which we are now concerned with.

American investors will want to keep currently informed as to the status of their investments. This quite natural and justifiable demand would seem to require at least annual statements from borrowing countries and their enterprises which will keep up to date the information contained in the original registration application. Further the information now required might very well be expanded to cover some of the problems not involved in domestic investment.

For example, the balance of payments position of importing and exporting countries is a matter of vital interest to their foreign creditors. Information on this subject would naturally be expected by investors who had, like the American public, become accustomed during the past decade to being kept informed on the affairs of corporations issuing securities.

But in spite of all the information that might be required under presently existing statutes or by extension or amendment of these statutes, there are some who still feel that the American public has not adequate protections in respect of foreign borrowers. This opinion has been expressed recently in Congressional circles with respect to the proposed repeal of the so-called Johnson Act. This Act, as you know, prevents the sale to the public of any obligation of a foreign nation in default to the United States government. In opposing repeal of the Act, several members of Congress have raised questions as to what protections will be afforded to replace those which the Act was designed to provide. These representatives may not be satisfied that the disclosure of information provides a satisfactory answer to their questions.

In view of the difficulties encountered during the early period -- how shall we proceed from here on? Is there in the experience of this early period a lesson for us? Shall we wait and watch, shall we be satisfied if bankers and underwriters merely comply with disclosure requirements? Or shall we try to work out a policy to guide foreign investment and to correlate it with our foreign economic and commercial policies? These are some of the questions which are of current daily concern to many officials of the government in Washington. They must, of course, be dealt with carefully but promptly, and at any rate, before the private markets open up as they eventually will, to the foreign borrower.

I have undertaken to raise these questions at this meeting for two reasons. First, as I have indicated, they stem from problems of vital interest to the States and, secondly, to solicit the views of the States in their solution. Our Commission, is perhaps best placed to be of assistance to all Departments of the Federal Government in the solution of the National problem. We cannot, in my opinion, render that service to the best effect unless we are made conscious of the views of the various states. I therefore ask you to communicate these views to us and to permit us to act as a clearing house on your behalf.