

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

February 12, 1938

The Honorable
The Chairman of the Securities and Exchange Commission
Washington, D. C.

My dear Mr. Chairman:

I am enclosing herewith a copy of our reply to Dr. Herbert Feis, Adviser on International and Economic Affairs, Department of State, stating the Board's position on the memorandum by Messrs. Shoop and Roseborough, outlining a plan for an organization in London to facilitate European transactions in American securities.

May I express my appreciation of the courtesy of the Acting Chairman in sending me a copy of your own reply to Dr. Feis with his letter for January 31.

Very truly yours,

M. S. Eccles
Chairman

Enclosure.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Dr. Herbert Feis
Adviser on International Economic Affairs
State Department
Washington, D. C.

Dear Dr. Feis:

The Board of Governors has given consideration to the document enclosed with your letter of January 20. The plan described in the document is essentially one for expanding the market for American (and Canadian) securities abroad. The Board is aware that the proposed use of the nominee and depositary system to achieve this end is not an innovation. Similar methods are already being employed in various countries abroad. Nevertheless the Board cannot approve the establishment of a strong international organization designed to employ these instruments to the full throughout Europe with the purpose of encouraging foreign investment in American securities.

The flow of foreign funds into our stock market in recent years has not proved to be constructive. The flow did not get under way in substantial volume until the spring of 1935 when the stock market advance had already begun, and it was checked when the stock market turned downwards at the end of March 1937. During this period foreigners put more than \$1,000,000,000 on balance into American securities. This heavy foreign buying at a time when Americans themselves were optimistic tended to overstimulate the advance in stock prices. Subsequently when further investment of foreign funds might have been a stabilizing factor in the market, foreign investment here lost its vigor. The experiences of the late twenties were much the same. The fact is that foreign investors in the post-war period have accentuated stock market bonds and have done little to check stock market declines. In view of the vital part played by capital markets in the modern business world this accentuation of speculative tendencies is a disorganizing influence in the entire economy.

The Board is not impressed by the statement of the sponsors of the plan that the proposed organization would tend to isolate the effects of European trading. When foreign buying of American securities exceeds sales the excess purchases must be made on the American market; and it is these purchases, unmatched by foreign sales, that tend to be greatest in periods of speculative advance and to produce the most disturbing effects. The larger the European interest, the greater the adverse consequences are likely to be.

In addition to their direct influence upon the American capital market, European operations in American securities have been the largest single factor in bringing gold to the United States in recent years. The inflow of gold has been on an unprecedented scale and has required the adoption of special measures by the Board and by the Treasury to prevent excess reserves of commercial banks from becoming dangerously enlarged. Further substantial movements of gold to this country, such as might be caused by a renewed flow of foreign capital into our markets, are to be deprecated. The proposed organization would further such undesirable developments.

The Board appreciates the opportunity afforded it for an expression of its viewpoint on the proposed organization. Following the procedure initiated by the Securities and Exchange Commission copies of this letter are being transmitted to the Securities and Exchange Commission, the Treasury Department, and the Department of Commerce.

Faithfully yours,

M. S. Eccles
Chairman

W.HG/lgf