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# I

## INTRODUCTION

THIS IS THE FOURTH REPORT of an exploratory committee on financial research to be issued during the past quarter of a century. The first report, *A Program of Financial Research*, was published in 1937. It was followed in 1946 by *Research in Securities Markets*, and in 1954 by *Research in the Capital and Securities Markets*. The present report concentrates principally on the capital markets. Like the others, it is the product of a broadly based exploratory committee established under the auspices of the National Bureau. The purposes of the Committee were twofold: to survey the present state of knowledge of the capital markets and, on the basis of its findings, to recommend directions in which further research would be most fruitful.

In economics, as in the other social sciences, research produces few complete solutions to problems. Often work on particular problems is stopped not so much because fully satisfactory answers have been found as because, with the passage of time, new problems arise which supersede the old ones. We move around problems, more than through them, as the unfolding of events brings about a reordering of priorities. Nevertheless, an underlying continuity does exist between the problems of one decade and those of the next, so that properly conceived economic research yields knowledge which is cumulative over time. This is clearly evidenced by a brief glance at the first of these reports, *A Program of Financial Research*.

In surveying the state of knowledge in 1937, as a basis from which to recommend priorities for further research, the Committee found that there was a lack of any conception of the most elementary magnitudes involved in the financial structure. In the words of the report:

. . . a comprehensive survey of the financial structure as a whole is urgently needed to provide a background for the analysis of financial problems and to give perspective to proposals for changes in the financial structure. . . . This survey must not be limited to central banks and commercial banks where our information is now relatively most complete. It must include the activities of savings banks, building and loan associations, Morris Plan banks, mortgage banks, investment banks, insurance companies, finance companies, and underwriting houses. It must be sufficiently comprehensive, furthermore, to show not only the structure and functions of these various types of financial organization taken individually, but also their relative importance and their interdependence. Without this basic financial survey . . . it is impossible to come to any well considered opinion concerning many of the most pressing financial problems of today.<sup>1</sup>

1. *A Program of Financial Research*, New York, NBER, 1937, Vol. One, pp. 23-24.

It is obvious to even a cursory observer of the financial scene that matters have improved greatly since issuance of the report quoted above. One has only to mention the continuous stream of data emanating from the Federal Reserve's flow-of-funds section, Kuznets' *Capital in the American Economy: Its Formation and Financing* (1961), Goldsmith's monumental *A Study of Saving in the United States* (1955), his *Financial Intermediaries in the American Economy since 1900* (1958), his *The National Wealth of the United States in the Postwar Period* (1962), and his joint work with Lipsey, *Studies in the National Balance Sheet of the United States* (1963), to realize that, for sheer data and information on financial institutions and practices, we are incomparably better off than we were a quarter century ago. These works, along with many others from university scholars, government agencies, and private research organizations, now provide us with a body of knowledge on the functioning of our financial system which is undoubtedly superior to that available in any other country in the world. Furthermore, this knowledge has been growing at a rapid rate in recent years; indeed, most of it has been accumulated in the last decade.

This does not mean, however, that there is no need for further research in this field. There are still significant gaps in the available data, as well as a pressing need for the interpretation of the existing data. These topics are the concern of the present document. The recommendations which emerged from the discussions in the Exploratory Committee on identifying the areas most in need of further research are presented in Parts II and III below. Part II is concerned with research topics which encompass the capital market as a whole, and Part III with narrower sectors within the capital market, corresponding roughly to the conventional classification of sectors by type of market instrument.

As a basis for forming its judgments, the Committee first surveyed the status of recent research in the field, including that currently in progress or planned. This "inventory" is presented in Part IV, in the hope that it will provide a helpful checklist for others.

Before turning to the research recommendations, a word is in order about the general orientation of the report. In the first place, in exploring the needs for further research in the capital markets, the Committee attempted to keep the scope of its inquiry within manageable proportions by confining itself primarily to financial markets, in contrast to factor and product markets. In the financial markets, it concentrated mainly on intermediate and long-term financing, in contrast to flows of short-term funds.

At the same time, there was full awareness that financial markets cannot actually be separated from the markets for goods and services, and that flows of intermediate and long-term funds are intimately connected with flows of short-term funds. Aspects of these relationships are thus found among the Committee's recommendations. The fact that there is not more on the "real" aspects of economic activity, or on short-term

financial markets, does not imply that knowledge in these areas is adequate; it simply reflects the definition of the scope of the report.

Second, no attempt has been made to specify an order of priorities among the research projects recommended below. In a general way, most of the Committee members felt that the topics in Part II were more important than those in Part III, i.e., that analysis of the capital market as a whole deserved priority over more intensive work on any one sector within that market. The report lists the research areas we think need further exploration; the reader is free to assign to them any priorities he believes appropriate.

Third, it is worth noting that there was a strong feeling within the Committee—which is reflected in its recommendations—that the time had come to emphasize analysis and interpretation instead of the accumulation of additional data. For whereas an imposing body of facts and figures has been accumulated on the capital markets in the past decade, there has been much less interpretation of these data. This does not, of course, mean that we already have all the data we need; there are still many areas, as indicated below, where analysis is hampered by inadequate factual knowledge. But in other areas it is imperative that the opposite imbalance be redressed, and that more emphasis be placed on the consolidation, interpretation, and analysis of data already at hand.

Fourth, the Committee feels that the research recommended below would have the maximum impact if it were directed, as far as possible, toward illuminating the major economic issues encountered in the formulation and execution of public policy. This would involve outlining alternative courses of action and consideration of their possible consequences. Theoretical and empirical analyses of current relationships and prospective tendencies, as well as the development of historical perspective, are of course essential ingredients in policy-oriented research. But the full value of the insights gained will not be realized unless their bearing on controversial aspects of current policy problems is made clear. Although this is frequently hazardous, the Committee strongly feels that the results would be worth the effort in terms of professional contribution to an informed consideration of the issues in question.

Fifth, it is not contemplated that the various projects proposed here will be undertaken by any single group or institution. On the contrary, it is the Committee's hope that this report will stimulate research in the capital markets in many quarters and by many people.

Finally, it should be understood that this report is the product of the Committee as a whole. Within the Committee, opinions differed as to the value of individual research projects. Every member of the Committee does not therefore necessarily endorse each and every recommendation made in the following pages.