Of Crashes, Corrections, and the Culture of Financial Information—What They Tell Us about the Need for Federal Securities Regulation

C. Edward Fletcher III

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OF CRASHES, CORRECTIONS, AND THE CULTURE OF FINANCIAL INFORMATION—WHAT THEY TELL US ABOUT THE NEED FOR FEDERAL SECURITIES REGULATION

C. Edward Fletcher, III*

In this article, the author examines financial data from the 1929 crash and ensuing depression and compares it with financial data from the market decline of 1987 in an attempt to determine why the 1929 crash was followed by a depression but the 1987 decline was not. The author argues that the difference between the two events can be understood best as a difference between the existence of a "culture of financial information" in 1987 and the absence of such a culture in 1929. The article further argues that this culture of information is a direct result of the federal mandatory disclosure system put in place in the 1930's. Thus, the author concludes that the federal securities laws are largely responsible for the economy's ability to avoid a depression after the market correction of 1987.

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I. Introduction

On October 19, 1987, investors on the New York Stock Exchange lost more than $400 billion. Total losses for stock investors in the United...
States were closer to $720 billion. To put that in perspective, imagine a vertical stack of 720 billion dollar bills. If a stack of one hundred dollar bills is one-half inch high, a stack of 720 billion dollar bills would be 56,818 miles high—more than one quarter of the way to the moon. If laid down along the equator, the stack would stretch around the world twice.

Although it would be an understatement to say that the day was a disappointment to most American investors, the news was not all bad, at least from a systemic point of view. The market downturn of October, 1987, and subsequent events tell us some very good things about the system of securities regulation in this country. In a sense, the events since then demonstrate the efficacy of federal securities regulation. The purpose of this article is to explain why that is so.

My thesis is not that every aspect of that mandatory disclosure system is a good thing. Rather, my point is simply that the existence of some system of federally mandated disclosure by public corporations of financial information is a good thing. I suggest that the positive nature of our regulatory framework is demonstrated by examining what has improperly come to be known as the “crash” in the equity markets that occurred in October, 1987 and comparing it with the crash of 1929. The consensus

(NYSE) was, in October 1987, more than two trillion dollars. See Gammill & Marsh, Trading Activity and Price Behavior in Stock and Stock Index Futures Markets in October 1987, 2 J. Econ. PERSPECTIVES 25, 42 (1988). The Standard and Poor’s 500 Index lost approximately 20.47% on October 19, 1987, declining from 282.70 at the close of the preceding trading session to 224.84 at the close of trading. See 4 OTC DAILY PRICE RECORD, Part I (Oct.—Dec. 1987). Because the S & P 500 is not an index of the NYSE in the aggregate, I have rounded off the loss to 20 percent. The total was undoubtedly higher or lower, but only slightly.

2. The total equity capitalization in the United States in 1987 was approximately $3.6 trillion. See Leland & Rubinstein, Comments on the Market Crash: Six Months After, 2 J. Econ. PERSP. 45, 48 (1988). To reach the $720 billion figure, I multiplied that total capitalization figure by the percentage loss in the S & P 500 of October 19, 1987. The $720 billion figure may underestimate the total losses. See Runkle, Why No Crunch From the Crash?, Fed. Reserve Bank of Minneapolis Q. REV. 2 (Winter 1988) (suggesting that the total loss in equity values was almost $1 trillion). The actual aggregate loss figure was probably slightly less than $720 billion on October 19, 1987, itself, since the over the counter (OTC) markets lost only approximately 11% on that day; they lost another 9% the following day, however. See 4 OTC DAILY STOCK PRICE RECORD, Part I (Aug.—Oct. 1987). Since the NYSE represents nearly half of the total equity capitalization in the United States, the fact that the OTC markets took an extra day to lose as much as the NYSE lost in one day is insignificant.

3. Those who held net short positions on October 19, of course, achieved tremendous gains. Short selling is the practice of selling a security that one does not own (the security is generally borrowed from one’s broker) with the hope that the security will decline in value, allowing one to close out the transaction by purchasing the security back for less than one sold it. See J. Seligman, The Transformation of Wall Street (1982).
concerning the downturn of October remains that it illuminated a problem of market mechanisms. This article contends that the most important lesson of that drop in prices is that the system of federally mandated disclosure put into place by the Securities Act of 1933 and the Securities Exchange Act of 1934 works precisely the way it was designed to work.

More specifically, this article will advance the thesis that we live today within a "culture of financial information" and that the existence of this culture and its absence in 1929 partially explain why the crash of 1929 was much more catastrophic than the correction of 1987. That larger thesis entails two lesser propositions: First, one of the most immediate causes of the crash of the securities markets in the period from 1929 to 1932 was a lack of publicly available information concerning the companies whose securities were being traded. And second, the federal system of mandatory disclosure—the government's response to the 1929 crash—worked as it was designed to work: it prevented a similar catastrophe in October of 1987. In other words, the lack of a culture of financial information in 1929 partially explains the causal nexus between the 1929 crash and the great depression, whereas the existence of such a culture accounted for the correction of 1987 and has not (and will not) lead to a similar depression.

Part II of this article discusses the dearth of reliable information in the years leading up to the crash of 1929 and suggests that the lack of information can be understood as a primary cause of both the speculation preceding the crash and the depression that followed. Part III suggests that the system of mandatory disclosure put into place at the federal level in the early 1930's helped to create a culture of information. Part III also contends that the existence of that culture of information can be viewed as one reason the correction of 1987 was not 1929 redux. Finally, Part IV concludes that if there was any doubt concerning the advisability of our system of mandatory disclosure before 1987, there should be none now.

II. THE PERILS OF NON-INFORMATIONAL MARKETS: A REEXAMINATION OF THE 1929 CRASH

A. The Dearth of Reliable Information in the 1920s—Theory and Fact

Historically, the critique of our mandatory disclosure system has been advanced along three primary lines. Some have used economic theory in


an attempt to show that mandatory disclosure is unnecessary because firms have incentives to produce precisely the proper quantity of public information.\textsuperscript{7} Others have argued that the implementation of a mandatory disclosure system in the 1930s was unnecessary because firms were already voluntarily disclosing the information needed by investors.\textsuperscript{8} The third line is represented by those who conclude from available data that investors are neither more wealthy nor more free from fraud after mandatory disclosure than they were before mandatory disclosure.\textsuperscript{9}

If either of the first two arguments is correct, my argument fails. I suggest that the dearth of reliable information in the 1920s is one explanation why both the crash of 1929 and the ensuing depression were so bad. If either of the first two lines of criticism is correct, there was no dearth of reliable information in the 1920s. The third line concerning the wealth effects of mandatory disclosure is irrelevant for my purposes, and for that reason, this article will not address that contention directly. Nonetheless, if correct, my analysis would suggest that there may be benefits to mandatory disclosure other than prevention of fraud and increased share prices.

1. Mandatory Disclosure and Economic Hypotheses

The wisdom and efficacy of mandatory disclosure has been a popular subject of debate in securities literature.\textsuperscript{10} Many opponents of mandatory disclosure have theorized that such a mandate is unnecessary since firms have market incentives to make an optimal level of disclosure.\textsuperscript{11} Judge Easterbrook and Professor Fischel have put forth the most cogent statement of the theory, and their version is worth quoting at length:

To see how this works, take a simple example of a firm that wants to issue new securities. The firm has a project (say, the manufacture of


\textsuperscript{9} See, e.g., id.

\textsuperscript{10} The contributors to the debate can be grouped in three broad categories. Some argue that mandatory disclosure simply is not a good policy. See, e.g., H. Kripke, \textit{The SEC and Corporate Disclosure: Regulation in Search of a Purpose} (1979); Benston, \textit{supra} note 8; Benston, \textit{The Effectiveness and Effects of the SEC's Accounting Disclosure Requirements}, in \textit{Economic Policy and the Regulation of Corporate Securities} 23 (H. Manne ed. 1969). Others have been champions of mandatory disclosure. See, e.g., Coffee, \textit{Market Failure and the Economic Case for a Mandatory Disclosure System}, 70 VA. L. REV. 717 (1984); Seligman, \textit{The Historical Need for a Mandatory Corporate Disclosure System}, 9 J. CORP. L. 1 (1983). Still others have voiced qualified criticism. See, e.g., Easterbrook & Fischel, \textit{supra} note 7.

\textsuperscript{11} Professor Seligman has collected and summarized many of these theoretical arguments. See Seligman, \textit{supra} note 10, at 8-24.
a new computer) that it expects to be profitable. If the firm simply asked for the money without disclosing the project and managers involved, however, it would get nothing. Investors would assume the worst . . . . Silence means bad news. A firm with a good project, seeking to distinguish itself from a firm with a mediocre project (or no project at all), would disclose the optimal amount of information. That is, it would disclose more and more so long as the cost of disclosure . . . was worthwhile to investors as a whole.  

Since the return to investors is decreased by the investor's cost of acquiring information, self-interested companies will disclose much information to lower that cost and thereby increase the level of investor interest: "Firms that promise to make disclosures for this purpose will prosper relative to others, because their investors incur relatively lower costs and can be more passive investors with safety. The more convincing the promise, the more investors will pay for the stock."  

Easterbrook and Fischel even argue that firms will react to incentives by permitting investors to monitor the accuracy of that disclosure, thereby offering investors substantial protection and making it possible for high quality firms to raise money. "Investors, after all, need not donate cash to new firms . . . . New or less well known firms can obtain money only if they offer packages more attractive than those already existing."  

To take an example, imagine two firms, A and B. Firm A makes complete and truthful information about itself available to the market, whereas Firm B discloses nothing or discloses only good news. Because potential investors in this hypothetical world value complete and truthful information, all other variables being equal they should be willing to pay more for Firm A stock than for Firm B stock. That would result in a lower cost of capital for Firm A compared with Firm B, resulting in a competitive advantage to Firm A. Therefore, the Firm Bs of this hypothetical market would either disappear as a result of their competitive disadvantage or they would come to their senses and start making optimally complete and accurate disclosure about themselves. That is how the market should operate without regulation.

Sadly though, the real world has often shown a stubborn unwillingness to conform to economic models. There are numerous problems with this sort of theory of incentives for voluntary disclosure, and Professors Coffee and Seligman have both offered critiques. I concur in much of their criticisms and will not repeat them. But there are other reasons to question the type of theory the Easterbrook and Fischel have put forth. At a very general level, that sort of model has difficulty accommodating the role that ignorance, stupidity and greed play in human actions, and that

12. Easterbrook & Fischel, supra note 7, at 683 (footnotes omitted).
13. Id. at 685.
14. Id. at 676-77.
15. See Coffee, supra note 10, at 718-43; Seligman, supra note 10, at 5-8.
difficulty accounts for the divergence between the ideal scenario just described and what actually happens in securities markets in the absence of regulation.

But there are at least five more substantive flaws in the Easterbrook and Fischel theory. First, they commit the error that has repeatedly been pointed out by critics of positive economic theory: they presume the rationality of investors, or "assume the can opener."16 The problem addressed by securities regulation is precisely that investors do not act rationally. They become greedy and fail to eschew risk even when it is in their best interest to do so. Investors will not collectively demand an optimal amount of disclosure; a clever salesman can sell many members of the public almost anything. Investments are often made upon impulse, upon hunches, or upon relatively baseless hopes of future wealth. Investors repeatedly demonstrate a willingness to undervalue the truthful character of information and overvalue rosy projections that promise to make them rich. Thus, given a choice between two investments—stock in Firm A, which historically has made truthful and complete disclosure about itself and which now projects moderate growth, and stock in Firm B, which has never made any disclosure about itself but which now claims to be on the threshold of vast growth and riches—investors have shown an uncanny propensity for choosing the stock in Firm B. How else can we explain the South Sea Bubble, in which vast quantities of money were raised for ventures only sketchily described. Professor Loss recounts one investment of the period in which the venture was described as "an undertaking of great importance, but nobody to know what it is."17 The offering was a hit with investors.18

In fact, for many investors there seems to be an inverse relationship between the demand for information and the plausibility of the disclosure being made: the more grandiose the promises being made by the sales person, the less regard the investor has for the facts. The law prohibiting fraud exists precisely because people fail to take steps to protect themselves when it would be rational for them to do so. In short, there is no reason to accept the presumption of investor rationality and much to suggest the contrary presumption.

16. This is a reference to the joke about economists that goes like this: An economist, a physicist, and a mechanical engineer are adrift in a boat and are running out of food. There is only one can of food, and the three must figure out how to open the can. The physicist explains to the others her elaborate theory for exploding the can open using the heat of the sun. The mechanical engineer describes her theory designed to crack the can open by means of a complex lever system using the boat's oars. The economist begins presenting her solution by saying, "Assume we have a can opener . . . ."


18. See id.
Second, even if investors were wholly rational in their actions, they might still ignore the disclosed information. Without a government mandate for full and complete disclosure, investors have no way of being sure that Firm A’s disclosure is complete and accurate. Such investors may therefore be rationally sceptical concerning any given piece of information voluntarily disclosed, even when the disclosure comes from a company that has in the past always made truthful and complete disclosure. Of course, common law has long proscribed outright fraud, but the state common and statutory law in the early twentieth century inadequately disciplined firms that engaged in willful fraud when making disclosure.

Third, again even assuming investors were rational and therefore consistently demanded some quantum of information from firms selling securities, there is nothing to suggest that the incentives involved would result in an “optimal” level of disclosure as Easterbrook and Fischel contend. At some point the marginal utility to the company of additional disclosure would become less than the marginal gains from new investment, but that may or may not be a point of optimality.

Easterbrook and Fischel seem to stand on a definition of optimality that is tautological. That is, the level of optimal disclosure for them seems to be that level of disclosure on which rational firms and rational investors would agree. But that is the optimal level of disclosure only in the same sense that a fair wage is that which workers and management would agree upon. “Optimality” for purposes of disclosure and “fairness” for purposes of wages both contain normative aspects, whereas the tautological definition of optimality preferred by Easterbrook and Fischel is merely descriptive (just as the free market definition of a fair wage is merely descriptive). In both circumstances we as a community may decide that the optimal level of disclosure or the lowest fair wage is something more than that in which the market forces would result.

The fourth problem with theories such as that put forward by Easterbrook and Fischel is that there exist strong counterincentives for firms to be less than truthful with important financial information. A given firm may find the promulgation of false or overly optimistic information or the withholding of truthful negative information to be in its best interest. This would be dependant upon whether the penalty for being

19. Pollock and Maitland have traced the law of fraud back to the time of King John, when there existed a writ of deceit (breve de deceptione) available at first only for deceits of the court (deceptio curiae). See 2 F. POLLOCK & F. MAITLAND, THE HISTORY OF ENGLISH LAW BEFORE THE TIME OF EDWARD I 534-36 (2d ed. 1952).

20. Professor Loss has provided a short and entertaining history of securities regulation by English statute and by the American states and describes the failure of state regulation in this country. See L. Loss, supra note 17, at 1-7. See also infra notes 157-58 and accompanying text (describing inadequacy of state law before
caught discounted by the probability of being caught is low enough. As Easterbrook and Fischel themselves recognize, "Some firms will find fraud to be the project with the highest net present value." Professor Ken Dau-Schmidt has explained this phenomenon in the context of the rational consumer's response to unregulated product advertising:

If a producer can mislead consumers in a way that can be discovered only after the consumer has purchased the good, the producer can increase his or her profits by selling a cheaper and inferior product . . . to consumers. Not all producers will adopt this strategy, and in fact some producers may make a point of never lying to consumers in order to cultivate trust and loyalty. However, realizing producers' incentive to lie, a consumer would be foolish to fully believe all producer claims. The result is that . . . rational consumers discount the truthfulness of the advertisements.

The fifth and final problem with the economic theories predicting an optimal level of disclosure without government mandate is that the evidence simply does not support the theory. One of the great strengths of the law and economics movement has been its demonstration that many of our a priori beliefs and theories are simply not backed up by the data. The proof, as the saying goes, is in the pudding, and in the absence of government compulsion, investors simply do not demand and firms simply do not provide reliable and complete financial information.

A.A. Sommer tells the story of Harvey Firestone sitting up late one night with a group of accountants, business people, and lawyers putting together an offering circular for Firestone Rubber in the days before mandatory disclosure. As the meeting wore on, Firestone is reported to have said, "Gentlemen, doesn't most of your difficulty stem from a desire to be something less than candid?"

Although the Firestone story is merely anecdotal evidence that firms do not have sufficient incentives to be forthright, there is more systematic evidence as well. Professor Coffee examined the municipal bond market, which is not subject to the federal disclosure requirements of the 1933 Act, to test the economic hypothesis of voluntary disclosure incentives. His conclusion was that the evidence strongly suggests that disclosure in the municipal bond market is inadequate. In addition, at least one survey has concluded that voluntarily disclosed information provided by municipal bond issuers is often unreliable. The SEC has recently recognized this

23. Discussion and Comments on Papers by Professor Demsetz and Professor Benston, in Economic Policy and the Regulation of Corporate Securities 89 (H. Manne ed. 1969) (remarks of Mr. A.A. Sommer, Jr.).
problem and proposed a new Rule 15c2-12, which would seek to “prevent fraud by improving the extent and quality of disclosure in the municipal securities markets.”

In summary, if firms had sufficient market incentives to make the needed disclosure without government mandate, there could not have existed a paucity of reliable financial information in the 1920s. Therefore, the supposed lack of reliable information could not even partially explain the severity of the 1929 crash and ensuing depression. Further, if there were no such dearth of information in 1929, mandatory disclosure could not be regarded as the saving force in the post-October, 1987 period. The theoretical basis for the assumption that firms in the 1920s already had adequate incentives to make sufficient disclosure is weak. A more direct way to address the question of the adequacy of the disclosure in the 1920s, however, is to examine the second line of argument that has been put forward in critique of the mandatory disclosure system. That second line of argument is that firms did make adequate disclosure in the 1920s.

2. Evidence of Information Production in the Absence of Mandatory Disclosure Rules

The evidence is undisputed that before 1900, corporate disclosure was, at best, meager. Were matters different after the turn of the century as investors became more financially knowledgeable? The answer seems to be no.

I have already presented some evidence suggesting that in the absence of government intervention firms elect not to disclose an optimal level of information. In fact, there exists a great deal of anecdotal, yet nonetheless persuasive, evidence suggesting that in the years immediately before the 1929 crash, firms selling securities were not disclosing very much information about themselves and were disclosing misleading information when they disclosed anything. As Professor Seligman has pointed out, the typical offering circular of the day contained little or no financial information.

Two Wall Street attorneys of the day have described those offering circulars:

Prior to the 1933 Act, issues put out by even reputable houses were frequently sold on the basis of what would today be considered as rather sketchy information. A typical offering circular for that period contained

little or no financial information, very little information as to use of
proceeds, a rather brief description of the securities themselves and few,
if any, material facts relating to the business of the issuer.29

Another commentator of the period described the typical pre-1933 pro-
spectus as "ludicrously inadequate."30 Perhaps the most telling testimony
comes from a former head of Kuhn Loeb & Co., writing in 1937: "[T]he
ease of selling poor quality and overpriced securities was enhanced by
the frequent absence of adequate information for buyers of securities and
for securities analysts and experts . . . ."31

Statements by Congressmen made during the debates over the 1933
Act also evidence the prevailing attitude of the day that investors were
not demanding and firms were not providing sufficient disclosure. A
House committee report of the period summarizes that view: "Alluring
promises of easy wealth were freely made with little or no attempt to
bring to the investor's attention those facts essential to estimating the
worth of any security."32

Instead of an optimal level of disclosure predicted by modern economic
theorists, one Senator pointed out that investment decisions were made
largely on the basis of salesmanship:

People have been persuaded to invest their money in securities without
any information respecting them, except the advertisements put forth by
the agents or representatives of those issuing the securities, and such
advertisements have not given full information to the public. . . . People
were persuaded to put their money into these investments . . . often
because they were told that the price of the securities would go up and
that they would make money easily and rapidly by investing in them.33

Notwithstanding this great body of testimony, commentators continue
to suggest that firms in the years before 1929 were making adequate
disclosure.34 Even as recently as 1984, Easterbrook and Fischel contended,
with obvious hyperbole, that "[f]irms have been disclosing the most
important facts about themselves—and certifying those facts through third
parties—as long as there have been firms . . . ."35 How accurate are
these generous conclusions concerning the availability of information in

29. Hallenan & Calderwood, Effect of Federal Regulation on Distribution
30. Dean, The Lawyer's Problems in the Registration of Securities, 4 L. &
Contemp. Probs. 154, 189 (1937).
31. Gourrich, Investment Banking Methods Prior to and Since the Securities
Act of 1933, 4 Law & Contemp. Probs. 44, 52 (1937).
32. Report of the House Committee on Interstate and Foreign Commerce,
33. 77 Cong. Rec. 2982-83 (1933) (remarks of Sen. Fletcher).
34. See, e.g., Benston, supra note 8, at 136.
35. Easterbrook & Fischel, supra note 7, at 684.
the 1920s? The answer is, there was a lot of information available about many firms. This information, however, was so inconsistent, incomplete, and unreliable that it could not form an adequate basis of financial information sufficient to weather the wild speculation and subsequent market crash from 1929 to 1933. The problem, in other words, was not one of quantity but of quality.

Decades before the crash in 1929, investment services tabulated financial information regarding public companies. These volumes, such as the annual Moody’s Investment Manuals, provided interested readers with massive quantities of information. There were two primary problems with relying on such services for financial disclosure, however.

First, the information was disclosed voluntarily by the firms listed, and a given firm could disclose what it wished in the form it wished. The services had no leverage to compel any particular form of disclosure, nor did the services have any leverage to compel the disclosure of any information the firms themselves did not want to disclose. Second, the services were subscriber services like the Moody’s bond rating surveys of today; the firms being listed were the sponsors of the service, thus creating a suspect conflict of interest for the service.

One anecdote is telling of the sort of conflict of interest problem that might arise in such a situation. Blair & Co., a major Wall Street investment firm in the early part of this century, was a principal sponsor of the Moody’s Investment Service. In fact, the Blair & Co. logo appears prominently on the binding of the 1917, 1918, and 1919 Moody’s Manuals. Tom Shachtman has described an elaborate stock watering and market manipulation scheme of the late 1920s involving Blair & Co. The scheme in which Blair & Co. participated was run by Sinclair Oil (a firm whose financial information appeared in the Moody’s Manuals of the day) and organized by Henry Sinclair, the payor of the bribes in the Teapot Dome scandal.

This does not suggest, of course, that Blair & Co. at any time put pressure on Moody’s to color its analysis of Sinclair Oil. Indeed no such pressure would have been needed since the Moody’s information about Sinclair Oil came from Henry Sinclair himself. The story does, however, illustrate the conflicts of interests involved in the investment services of the day.

36. See, e.g., J. Moody, Moody’s Industrials (1925); J. Moody, Moody’s Manual of Investments—Industrial (1928); Poor’s and Moody’s Manual Consolidated, Industrial Section (1924); Poor’s and Moody’s Manual Consolidated, Industrial Section (1923).

37. Professor Coffee has pointed out the conflict of interest problem that this sort of sponsorship creates in modern bond rating services such as Moody’s and Standard and Poor’s. See Coffee, supra note 10, at 745-46.

But investment services were not the only sources of financial information. Many companies made reports to shareholders, disclosing much information in the process. But not all companies were forthcoming. In 1923, only 25 percent of New York Stock Exchange companies provided shareholders with annual and quarterly reports.\(^\text{39}\) By 1933, only 60 percent did so. Even then, the quantity and type of information contained in the reports varied.\(^\text{40}\) Because the information was voluntarily disclosed, the firms disclosed what they wanted to disclose and withheld whatever they wanted to withhold. And many chose to withhold the most important information about themselves. As late as 1933, 38 percent of all New York Stock Exchange companies were not disclosing their sales figures; seven percent were not disclosing the amount of depreciation expense; and fully 46 percent were not disclosing their cost of goods sold.\(^\text{41}\) Some did not even disclose their net income for the year.\(^\text{42}\) Even Yale economist Irving Fisher, who generally argued both before and after the 1929 crash that all was well,\(^\text{43}\) admitted in 1930: “It is, of course, impossible to tell to what extent . . . companies . . . are understating their earnings.”\(^\text{44}\) It would also have been impossible to tell to what extent companies were overstating their earnings.

Even modern attempts to piece together information about public companies of the day are made difficult by the unreliability of the information that was reported. Illustrative of that difficulty is the fact that Irving Fisher could assert in 1930 that price/earnings multiples were declining throughout 1929, from an average of 16.2 in January to 13 in October; Barrie Wigmore’s recent study shows that average price/earnings ratios peaked at about 30 in 1929.\(^\text{45}\) The data conflict, because the data are unreliable.

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40. Even Easterbrook and Fischel acknowledge this inconsistency problem. See Easterbrook & Fischel, supra note 7, at 684 n.25.

41. See Benston, supra note 8, at 133. Benston has suggested that investors do not care about much of the information the SEC requires to be disclosed, but has pointed out that one of the types of information not frequently disclosed—sales figures—would be of importance to investors. See Benston, supra note 10, at 41.


44. Id. at 83.

45. See B. Wigmore, infra note 68, at 27.
In the late 1960s and early 1970s, economist George Benston conducted seminal studies of the quantity of information available to investors in the years immediately before disclosure became mandatory. After presenting the data, his conclusion was that firms were making adequate disclosure without government mandate. Benston's methods have come under fire from numerous commentators, but others simply have accepted his conclusions as settled fact.

Because Benston's work has been the most comprehensive in its collection of data, it would be useful to examine that data. Even assuming that Benston's methods were without error, his data support precisely the opposite proposition from that put forth by Benston: the financial information available in the 1920s was of a type unlikely to have been relied upon by investors of the day. There existed a dearth of quality information, which prevented the rise of a culture of financial information. Without that culture of information, the speculation, crash, and depression were much more likely.

Benston first points out that the three major exchanges, the New York Stock Exchange, the American (Curb) Stock Exchange, and the Chicago (Midwest) Stock Exchange all required, as a condition of listing a company's stock, the companies to submit balance sheets and income statements to the exchange. These statements themselves reveal almost nothing since there were many factors that made the information required by the exchanges both incomplete and potentially inaccurate.

First, not all traded companies were listed on a major exchange. Second, the New York Stock Exchange permitted companies' securities to trade on the Exchange on an unlisted basis, obviating the need to comply with the disclosure requirements. Further, the exchanges were extremely lax about enforcement of their disclosure requirements, since

46. See Benston, supra note 8, at 133-49.
47. See, e.g., Friend & Westerfield, Required Disclosure and the Stock Market, 65 AM. ECON. REV. 467, 468-70 (1975); Panel Discussion, in ECONOMIC POLICY AND THE REGULATION OF CORPORATE SECURITIES 96-97 (H. Manne ed. 1969) (remarks of Mr. A.A. Sommer, Jr.). See also Coffee, supra note 10, at 718-19 n.9, 730 n.36 (collecting material critical of Benston's methods).
48. Easterbrook & Fischel seem to accept Benston's conclusions unquestioningly when they cite Benston's work for the conclusion that "at the time the 34 Act ... became law, every firm traded on the national markets made voluminous public disclosures certified by independent auditors." Easterbrook & Fischel, supra note 7, at 684. Curiously, the other source cited by Easterbrook and Fischel for that proposition contradicts the Benston/Easterbrook/Fischel contention that every listed firm made audited disclosures. In Watts & Zimmerman, Agency Problems, Auditing, and the Theory of the Firm, 26 J. L. & ECON. 613, 628-29 (1983), the authors point to Benston's finding that many New York Stock Exchange companies were not audited in the years immediately before the 1929 crash.
49. See, Benston, supra note 8, at 133.
their staffs were small and increasingly overworked.\textsuperscript{51} The New York Stock Exchange Stock List Committee ceased, sometime before the crash, making independent investigations of material submitted by companies that already had securities traded on the exchange, despite instances in which the information provided was obviously suspect.\textsuperscript{52}

In addition, an investor could not count on the material having been audited by an independent auditor before being submitted to the exchange. The exchanges did not require the information to be audited. In 1926, 18 percent of New York Stock Exchange (NYSE) firms were unaudited.\textsuperscript{53} Even in 1934 six percent of NYSE firms did not have independent auditors.\textsuperscript{54} According to Professor Seligman, 15 percent of all NYSE firms were unaudited in 1933.\textsuperscript{55} The fact that there existed a significant percentage of unaudited firms meant that investors could not assume for any given company that the information being submitted had been independently verified.

And even for those companies whose financial reports were independently audited, investors would not have been in a position to rely on their audited disclosures. In the 1920s, the auditing profession was in a nascent stage,\textsuperscript{56} and the stamp of a professional auditor did not carry then the import it does today. The confluence of the fact that accounting standards were still rather primitive with the lack of any effectively defined generally accepted auditing principles meant that management retained discretion to choose among several different ways of presenting the same information. As a result, many firms used that discretion to make their information look more rosy than it was.\textsuperscript{57} "[C]ommonly employed accounting practices did not provide investors with a reliable tool with which to compare the worth and performance of different firms."\textsuperscript{58}

The problem of unreliability of existing information was exacerbated by the widespread bribery of journalists in the 1920's by stock manipulators. Many writers and radio personalities received payoffs to tout companies' stocks.\textsuperscript{59} "Moreover, by 1929 numerous journalists were sternly resisting the more subtle blandishments and flattery to which they have been thought susceptible. Instead, they were demanding cold cash for news favorable to the market."\textsuperscript{60} Publicist A. Newton Plummer is reported

\textsuperscript{51} \textit{Id.}
\textsuperscript{52} \textit{Id.}
\textsuperscript{53} See Benston, \textit{supra} note 42, at 519, table I.
\textsuperscript{54} See id. For some reason, Benston reported four years later that his 1969 data showed that all NYSE firms were audited in the year 1933.
\textsuperscript{55} See J. Seligman, \textit{supra} note 3, at 48.
\textsuperscript{56} See Watts & Zimmerman, \textit{supra} note 48, at 628-29.
\textsuperscript{57} See J. Seligman, \textit{supra} note 3, at 48.
\textsuperscript{58} Id.
\textsuperscript{59} G. Thomas & M. Morgan-Witts, \textit{The Day the Bubble Burst} 78 (1979).
\textsuperscript{60} J. Galbraith, \textit{supra} note 43, at 78.
to have received more than $250,000 in fees for paying off journalists in newspapers such as the New York Times, the New York Post, and the Wall Street Journal to write favorable stories about firms’ prospects for increased production, greater demand for goods, etc.\textsuperscript{61}

In one instance, a group set up a pool to “invest” in the stock of Radio Corporation of America. The next day, the Wall Street Journal ran a story stating that the company “is financially better off than ever before in its history.” Shortly thereafter, a New York Daily News columnist who was later discovered to have been accepting payola wrote a favorable column about Radio in that newspaper. The pool’s profit on Radio Corporation stock was 4.9 million dollars in eleven days.\textsuperscript{62}

In the days before the federal securities laws there were also more subtle forces at work undermining the perceived reliability of investment information. Before the 1933 Act restricted the manner in which securities sales could be made,\textsuperscript{63} stocks and bonds were sold by way of attractive and enticing advertisements in newspapers and magazines.\textsuperscript{64} Techniques used to sell soap were used to sell securities, with the result being that investors relied on information concerning stocks approximately to the same extent that they believed the hype of soap advertisements. This “marriage of Wall Street and Madison Avenue” made it difficult for the public mind to distinguish between hard fact and puffery. All information was equally suspect and trustworthy.\textsuperscript{65} Thus, none was reliable.

All this is not to say that information was not available or was not a matter of interest to the market. In fact, as the data just described demonstrates, there was a certain quantity of information available to market participants. And anecdotes from the 1920s indicate that market-watchers were at least interested in some of that financial information. On March 23, 1928, John J. Raskob, a director of General Motors, suggested that General Motors’ prospects were good and that GM should be selling for a higher price/earnings multiple. The market reacted favorably.\textsuperscript{66}

\textsuperscript{61} See J. Seligman, supra note 3, at 16-17.
\textsuperscript{62} G. Thomas & M. Morgan-Witts, supra note 59, at 124-25, 131.
\textsuperscript{63} Section 5(c) of the 1933 Act, 15 U.S.C. § 77e(c) (1982), prohibits offers to sell securities before a registration statement is filed. The term “offer” is defined broadly in section 2(3) of the 1933 Act, 15 U.S.C. § 77b(3) (1982), to include any attempts to sell. Thus, section 5(c) effectively prohibits all sales promotions for securities until a registration statement is filed. In addition, section 5(b)(1) prohibits the use of written sales materials after the registration statement has been filed to SEC sanctioned materials. See generally T. Hazen, THE LAW OF SECURITIES REGULATION 31-50 (1985); L. Soderquist, UNDERSTANDING THE SECURITIES LAWS 45-62 (1987).
\textsuperscript{64} See G. Thomas & M. Morgan-Witts, supra note 59, at 75-78.
\textsuperscript{65} One Senator speaking in 1933 decried this sale exclusively by advertisement. See supra note 33 and accompanying text.
\textsuperscript{66} See J. Calabrese, supra note 43, at 18-19.
The problem was that the information was not complete enough to enable investors to make comparisons among investments, was inconsistent in its availability, and was unreliable even when it was available. Again, the problem was not of quantity but of quality. The quality problem precluded the development of a culture of financial information in which investors would rely primarily on financial information in their investment decisions. In the absence of information of reliable quality, a culture of financial information could not form, and in the absence of a culture of financial information, investors’ investment decisions were made on the basis of criteria other than financial information about the companies in which they were investing.

To understand fully the import of the absence of a culture of financial information, one must understand the nature of the speculative bubble that grew in 1929 and the crash and depression that followed. The most plausible way to understand those events is by seeing them as having been caused, at least in part, by the absence of what I have called the culture of information.

B. The Bubble, Crash, and Subsequent Collapse of the Economy

Since 1929, there have been countless theories put forward to explain the speculation and crash of the late 1920s. To some extent the debate is arid, since most of the theories probably have some grain of truth but also are probably inadequate explanations. Complex historical events can almost never be said to have been caused by one other event or action. Economic events, like other historical events, occur when there exists the proper confluence of factors.

We can, however, speculate that a given event was “caused” by some occurrence if we mean only that, but for the occurrence, the event would not have come about. My suggestion concerning the culture of financial information is this: the speculative bubble of 1929 would not likely have


68. One observer has recently argued that the money supply and Federal Reserve Board policy explanations are inadequate. See B. Wigmore, The Crash and Its Aftermath—A History of the Securities Markets in the United States, 1929-1933 91-101 (1985). Attempts to explain the depression by pointing to the Smoot-Hawley tariff bill, see Saint-Etienne, supra note 67, are also suspect, since that bill was not passed until June of 1930, by which time the economy was already skidding badly. See J. Galbraith, supra note 43, at 93. In fact, by that time the economy was strained enough that President Hoover was already trying remedial measures. See B. Wigmore, supra, at 115.
occurred had a culture of financial information been in existence then, and such a culture would have made much less likely the catastrophic crash and subsequent depression. In fact, I suggest that the lack of a speculative bubble in 1987 and the moderation with which the market and economy reacted when the correction came, show that the culture of information that exists now—brought about by our system of mandatory disclosure—is a critical difference between 1929 and 1987.

1. Market Pricing Without a Culture of Information.

Times were good in the United States in the 1920s. The country was at peace, industrial production was rising, people had more money than ever before, and Republican administrations were promising to take very little of that money from the people in taxes. Corporate profits rose approximately 80 percent in the decade, and inflation was nearly nonexistent.

Stock prices were up for the decade as a whole, but at least through 1927 were up not much more than earnings. While profits rose approximately 80 percent, stock prices increased approximately 100 percent from the beginning of the decade until 1928. Even then, however, investors paid only slight attention to the underlying indicia of value. Galbraith has said that the 1920s “was a good time to raise money for general corporate purposes. Investors would supply capital with enthusiasm and without tedious questions.”

Then in mid-1928, the character of the economic boom changed. Beginning in March of 1928, stocks doubled in value over an eighteen month period while earnings rose only slightly. The speculation had begun. The average common stock share was trading at 30 times earnings at the peak of the speculation; by comparison, in October 1988, the average share of common stock was trading at 12 times earnings. But, just looking at the average understates the degree of the speculation, since much of the frenzy came in the trading of only a large subgroup of stocks. As Table 1 shows, the price/earnings multiple of some stocks

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69. See J. GALBRAITH, supra note 43, at 7-17.
70. See J. SELIGMAN, supra note 3, at 2.
71. See W. STONEMAN, supra note 67, at i. In fact, in no year from 1922 to 1929 was the rate of inflation in the consumer price index greater than 2.6 percent, and in some of those years there was a slight decline in prices. See P. TEMIN, DID MONETARY FORCES CAUSE THE GREAT DEPRESSION? 6, table 3 (1976).
72. See J. SELIGMAN, supra note 3, at 2.
74. See id. at 17.
75. See J. SELIGMAN, supra note 3, at 2.
76. See B. WIGMORE, supra note 68, at 27.
was completely unconnected to asset value or to any realistic prospects for earnings growth:

Table 1: Price/Earnings Ratios and Returns on Equity, 1929

<table>
<thead>
<tr>
<th>Company</th>
<th>P/E Ratio at 1929 Peak</th>
<th>Market Price as % of Book Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adams Express</td>
<td>153</td>
<td>250</td>
</tr>
<tr>
<td>Alleghany Corp</td>
<td>108</td>
<td>671</td>
</tr>
<tr>
<td>Columbia Gramaphone</td>
<td>165</td>
<td>5,086</td>
</tr>
<tr>
<td>Goldman Sachs Trading Corp.</td>
<td>129</td>
<td>295</td>
</tr>
<tr>
<td>International Nickel</td>
<td>50</td>
<td>1,043</td>
</tr>
<tr>
<td>Burroughs Adding Machine</td>
<td>42</td>
<td>1,386</td>
</tr>
<tr>
<td>National City Bank</td>
<td>120</td>
<td>1,318</td>
</tr>
<tr>
<td>Radio Corp.</td>
<td>73</td>
<td>1,669</td>
</tr>
</tbody>
</table>

Various theories have been expounded to explain the speculation, and I do not challenge any of them. I do, however, suggest that previous explanations have been incomplete: the speculative bubble almost certainly would not have grown to the dimensions it reached had investors been provided and become acculturated to the reliance upon hard financial information. In other words, the absence of a culture of financial information was a "but for" cause of the speculation.

John Kenneth Galbraith has described the period immediately before the crash as "a mass escape into make believe" and "a part of a speculative orgy." Barrie Wigmore recently examined the statistics available for companies in the years immediately before the 1929 crash and concluded that based on the ridiculously low returns on equity most companies were achieving, "[investors'] high valuations placed little emphasis on earnings."

In debating the Securities Act of 1933, many members of Congress made statements that indicate they understood the causal nexus between the lack of reliable information and what one Senator called the "saturnalia of speculation." The following is typical:

It is generally recognized that the lack of complete disclosure of the results of business operations was one of the major contributing factors associated with the inflation of security values which preceded the crash of 1929. Had there been a more frank and honest expression of business and investment operations, millions would have been saved from the false impression that profit making would be continuous.

78. See B. Wigmore, supra note 68, at 28, table 1.7.
80. B. Wigmore, supra note 68, at 28.
81. 77 Cong. Rec. 2983 (1933) (remarks of Sen. Fletcher).
Even some observers of the day recognized the irrationality of what was going on. The Atlantic Monthly reported in the summer of 1929 its dismay: ""The spirit of speculation has obtained such a hold upon the investment public that previously accepted standards of value . . . have been disregarded in the blind belief that the old order has changed and old methods should be discarded." 83 Some broker-dealers also seemed to understand the possible fragility of the situation—many raised margin requirements from 10 percent to as high as 75 percent immediately before the crash. 84

But for investors as a whole, in place of a culture of financial information, there existed a culture of speculation: a culture in which investment decisions were based on tips, rumors, and hunches. John Kenneth Galbraith has described what had passed for investment analysis in the absence of a culture of financial information:

That much of what was repeated about the market . . . bore no relation to reality is important, but not remarkable . . . . At luncheon in downtown Scranton, the knowledgeable physician spoke of the impending split-up in the stock of Western Utility Investors and the effect on prices. Neither the doctor nor his listeners knew why there should be a split-up, why it should increase values, or even why Western Utility Investors should have any value. But neither the doctor nor his audience knew that he did not know. 85

For similar reasons, Seaboard Air Line (a railroad with lines in the southeastern United States) was said to be a speculative favorite, since it was thought to be an aviation stock with terrific growth potential. 86 The problem was not that there existed no information to correct the misperception; indeed Moody's Railroad Manual for 1928 contains a multi-page description of Seaboard, complete with a detailed map of its rail lines. 87 The problem was that, because of the pervasive unreliability of financial information, investors were not acculturated to care.

The result was a classic speculative bubble, which like speculative bubbles before it, 88 was made possible only because investors in the aggregate were not acculturated to know that the securities they were buying were grossly overpriced. 89 Investors neither knew nor cared what the price/
earnings multiple for a given stock was and neither knew nor cared whether the price/earnings multiple being paid was way too high in relation to historical price/earnings multiples for similar stocks.90 Such information was partially available but was inconsistent and unreliable.91 In the late 1920s, the stock market was in a speculative frenzy, fueled by low margin requirements, greed, and (perhaps most importantly) a lack of understanding on the part of investors as to what the companies behind the stocks really looked like on paper. In retrospect, the crash was almost inevitable.

2. Economic Panic in a Non-informational Market Environment

The same lack of a culture of financial information that made possible the speculative bubble, brought about a more severe crash and more devastating economic depression than might otherwise have occurred.

a. The crash—an overreaction in an informational void

When the crash came in 1929, it came relatively slowly and was a surprise to many financial forecasters. The market peaked in the first week of September. On September 3, the Dow Jones Industrial Average (DJIA) closed at 381.17, having traded as high as 386.1 earlier in the day.92 By September 10, the Industrials were down to 367.29; by September 20, they were at 362.05.93 The Industrial Average closed September at its nadir for the month: 343.45, down approximately ten percent from its peak, but nonetheless at its late July level.94

Prices held steady the first couple weeks of October, with the DJIA rallying to close at 352.86 on Thursday, October 10.95 Then prices slid gradually over the next 13 trading sessions, closing on Saturday, October 26 at 298.97, down approximately 13 percent for the month and off approximately 22 percent from the September high.96

Two days earlier, on October 24, an investment bankers' pool, formed by J.P. Morgan & Co. banker, Thomas Lamont, had purchased between 20 and 30 million dollars' worth of stocks on the New York Stock Exchange in an attempt to stabilize prices.97 The attempt failed.

When the market opened on Black Monday, October 28, much of the damage had already been done. Yet on that day, the DJIA lost more than

90. See supra notes 94-98 and accompanying text.
91. See supra notes 27-66 and accompanying text.
93. Id.
94. Id.
95. Id.
96. Id.
97. J. SELIGMAN, supra note 3, at 3.
38 points and lost another 30 points on Tuesday. That resulted in a two day loss of approximately 20 percent. The Industrial Average had lost more than one-third of its value in less than two months. Statistics not available to market participants in the Fall of 1929 show that the economy was cooling by mid-1929. Nonetheless, throughout the Fall of 1929, economists were relatively sanguine about the economy's prospects. The 1929 forecast for 1930 was of only a slight decline in the economy—no great surprise considering the economic strides made over the previous few years. In today's parlance, the economy appeared to be headed for a "soft landing." Herbert Hoover, surely, eventually rued his statement of Friday, October 25, 1929, that "[t]he business of the country, that is, production and distribution, is on a sound and prosperous basis." But that is what appeared to be the case: as far as investors knew in October, 1929, the economy was as robust as ever. Optimistic forecasts were the norm even into 1930. To say that the economists were wrong would be a grotesque understatement; with the crash in 1929, both the economy and the stock market began a plummet that has never been equalled.

Shortly after the October 28 debacle in the equity markets, the market rallied briefly, then continued its downward fall. On November 13, 1929, the DJIA stood at 198.69, a loss of more than 100 points from the mid-October levels. There was a reasonably strong rally in early 1930 that pushed the Industrial Average as high as 294.07, but the rally was short lived, and the market resumed its collapse. The collapse was painfully drawn out, and on July 8, 1932, the Industrial Average closed at 41.22, having lost 89 percent of its September, 1929 value. Between September 1, 1929, and July 1, 1932, the value of all stocks listed on the New York Stock Exchange dropped from approximately 90 billion dollars to just under 16 billion dollars—a loss of approximately 83 percent. Some leading blue chip stocks, such as General Electric, Sears, and U.S. Steel, lost as much as 90 percent of their value. Half of all the new securities sold between 1918 and 1928 had become worthless.

98. The Dow Jones Averages, 1885-1980 (P. Pierce ed. 1982).
100. J. Seligman, supra note 3, at 4 (quoting H. Hoover, Memoirs: The Great Depression 9 (1951)).
101. See P. Temin, supra note 71, at 77-78.
102. On October 30, the DJIA rose 28 points. The next day it rose another 15 points. The Dow Jones Averages, 1885-1980 (P. Pierce ed. 1982).
103. Id.
104. Id.
106. J. Seligman, supra note 3, at 1.
107. Id. at 2.
108. Id. at 1-2.
b. The ensuing economic collapse

The collapse of the economy was equally complete. By April, 1931, the national unemployment rate was 25.5 percent.109 By 1933, 20 million workers (out of a total population of 125 million) were unemployed.110 Productivity in 1932 was half what it had been in 1929.111 Wages and salaries in 1933 were 57.5 percent of their 1929 levels.112 National income in 1932 was a mere 48.5 percent of the 1929 national income.113 The gross national product declined by more than 30 percent from 1929 to 1933. Aggregate corporate profits went from 9.6 billion dollars in 1929, to 3.3 billion dollars in 1930. In 1931, American business actually lost 780 million dollars; in 1932, the loss was 3 billion dollars.114

Peter Temin has examined the data concerning the timing of stock market declines and earnings of various companies in the period from 1929 to 1933 and concluded that "the data are consistent with the hypothesis that the stock market decline was a result of the Depression, but [are] also consistent with the reverse."115 The two forces (market and economic) were clearly working in a symbiosis, spiraling downward together. The question as to which caused which is a bit of a chicken and egg puzzle. Although the data are equivocal, available evidence seems to suggest that the market collapse was more a cause of the economic collapse than an effect of it.

3. Explaining the Relationship Between the Crash and the Depression: Three Propositions

The most plausible explanation for the relationship between the market decline and the economic decline is this: the speculative bubble (caused by the unreliability of information116) burst, sending the stock market into a steep decline—a natural reaction the extent of which was commensurate with the extreme nature of the speculation. That in turn caused a crisis of confidence in the economy generally, which was made possible by the lack of reliable information concerning both the economy and the companies in which investors held shares. That failure of confidence on the part of business and consumers, then, resulted in a failure of the market to rebound, which in turn resulted in economic retrenchment. Economic retrenchment

111. J. Seligman, supra note 3, at 11.
112. See L. Chandler, supra note 109, at 36, table 3-1.
113. See id. at 25, table 2-5.
114. Id. at 27.
116. See supra notes 67-87 and accompanying text.
ultimately sent both the economy and the stock market tumbling together for several years. Without the crisis of confidence, the depression would have been unlikely, and with a culture of financial information, the crisis of confidence likely would not have occurred.

Connecting the causal links in a manner that plausibly explains the relationship between the 1929 crash on the stock market and the ensuing depression is an exercise largely in supposition. We know that the economy was beginning to turn down in the second quarter of 1929 even though forecasts were for renewed strength. Why did the economic slump become an economic depression? Peter Temin has succinctly phrased the salient question:

The downturn which started in the second quarter of 1929 might not have turned into the Great Depression. The economy is always deviating in one way or another from its trend. . . . We ask how events in 1930 differed from those in a short term depression. Alternatively, what happened in 1930 that did not happen in, say, 1921 or 1938?117

Indeed, what happened in 1929 that did not happen in 1987? Drawing conclusions on causation is largely a matter of examining and discarding competing explanations of an event. If I put a burning match to a piece of paper, how do we know that the match’s flame caused the burning of the paper? Because the burning of the paper is difficult to explain without according the match a causal role.

Similarly, it is difficult to explain the depression without according a causal role to the stock market crash. It is difficult to explain that causal role without acknowledging that a crisis of confidence was created by the crash. Further, it is difficult to explain that crisis of confidence without noting the absence of a culture of information. Three propositions together force the conclusion that the absence of a culture of information was a “but for” cause of the depression. Each should be examined in turn.

a. Proposition #1: The stock market crash in 1929 was a cause of the depression.

If not every economic downturn results in a depression,118 why was the 1929 downturn any different? Some have argued that factors such as tight monetary policy and the Smoot-Hawley tariff bill119 were responsible.120 Certainly the tariff bill was one reason the depression was as deep and as long as it turned out to be. But the evidence is unmistakable that the businesses and consumers reacted immediately to the stock market crash;

117. P. TEMIN, supra note 71, at 63.
118. See, e.g., Greenwald & Stein, supra note 105, at 3, 6.
120. See, e.g., C. Slicher BLANK, supra note 67, at 33.
the business/consumer slowdown did not wait for Smoot-Hawley. That bill was not enacted into law until June of 1930. By the time any economic effect of the bill could be felt, massive damage had already been done to the economy. Investment in 1930 was down 35.6 percent from its 1929 level; consumption was down 5.4 percent. GNP fell 9.52 percent. Corporate profits were down by nearly two-thirds. Industrial production was down 20 percent. Real income fell 11 percent. Smoot-Hawley simply cannot explain those immediate effects.

Neither could tight monetary policy be the sole explanation. Again, the reaction of economic actors to the crash was too immediate. The recent research of Barrie Wigmore suggests strongly that neither the Federal Reserve nor tight money can bear sole responsibility for either the speculation or the crash in the economy. Thus, explaining the depression without pointing to the crash as a cause is difficult.

Furthermore, we cannot say simply that the market followed the economy down. That is, we cannot say that the slowdown in the economy caused the market to crash. Although the economy had begun to slip in the second quarter of 1929, until late in the year, the economic decline was modest. As John Kenneth Galbraith has pointed out:

> Until after the market crash, one could reasonably assume that this downward movement might soon reverse itself. . . . There were no reasons for expecting disaster. No one could foresee that production, prices, incomes, and all other indicators would continue to shrink through three long and dismal years. Only after the market crash were there plausible grounds to suppose that things might now for a long while get a lot worse.

In short, the economic slump did not cause the market decline, and we cannot explain the economic depression that followed shortly after the crash except by according a causal role to that crash. The crash was certainly a cause of the depression.

b. Proposition #2: The way in which the 1929 crash operated as a cause of the ensuing depression was by creating a crisis of confidence on the part of consumers and business people.

If explaining the great depression without pointing to the stock market crash is difficult, so too is it difficult to explain how the stock market

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122. P. Temin, supra note 71, at 64.
123. Id.
125. See id. at 27.
126. See W. Stoneman, supra note 67, at vi.
127. See id. at ix.
crash affected the economy without pointing to the crisis of confidence that was created by the crash.

Could a massive loss of wealth ensuing from the market crash have caused the economic downturn? The evidence is to the contrary: the average American lost very little before he stopped consuming. And businesses retrenched long before market losses suffered in the market could have made their way through the economy.

The actual monetary effect of the market crash on consumers' pocketbooks was slight. The 1929 American population stood at 125 million persons. Only approximately 1.5 million of those people (1.2 percent) had brokerage accounts. Only somewhere between 15 and 20 million (between 12 and 20 percent of the population) were in families that lost money in the crash. Those investors most hurt by the crash—margin investors—made up less than one-half of one percent of Americans. And the extent to which even those investors were leveraged when the crash came has been exaggerated to some extent. By the time of the crash, many brokers had raised their margin requirements as high as 75 percent.

Except for margin investors who stood to lose much more than their investments, the investors who lost money in the crash lost very little in the first six months following the crash. The money "lost" was really nothing more than a deflation of the paper profits that had been "gained" during the speculative frenzy immediately before the crash. On "Black Monday"—October 28, 1929—the Dow Jones Industrial Average closed at 260.64, almost identical to its closing level on November 7, 1928. By early June of 1930, the market was approximately where it had been immediately after the crash and was at approximately the same level it had been in mid-October, 1928. Even by the end of 1930, market levels had receded down only to the levels seen in late 1927, shortly before the wild speculation began.

Individual losses were further ameliorated by the fact that many employers stepped in to guarantee their employees' individual accounts. Sears, Roebuck & Co., Standard Oil Co. (New Jersey), U.S. Steel, and Kroger Grocery and Baking all either guaranteed their employees' positions or took them over from the brokers.

Thus, for several months after the crash, the losses were felt by a small proportion of Americans and were primarily paper losses of earlier

130. See id. at 83.
132. Only approximately 600,000 people held margin accounts in October of 1929. See id.; J. Galbraith, supra note 43, at 83.
133. See B. Wigmore, supra note 68, at 29.
135. On June 9, 1930, the DJIA closed at 250.78; on October 17, 1928, the DJIA closed at 250.87. Id.
136. See B. Wigmore, supra note 68, at 23.
short-term gains. The same can be said of business losses. Businesses were not financially affected directly by the market crash except to the extent they held securities for investment. But such businesses would be included in the figures quoted above, which show how light losses were at first. But even for those businesses that held the most stock—brokerage firms—the losses from the crash were not crippling. Very few brokerage firms were put under by the crash, and the ones that were put out of business tended to be smaller firms in New England, Ohio, and Wisconsin.  

The data indicate that neither individuals nor businesses in the aggregate were affected drastically by the market crash, at least not immediately. What is curious, then, is that the individual and business reaction to the market crash was immediate and drastic. Almost immediately, consumers cut back on consumption and businesses quit employing people and quit producing goods and services. GNP fell by ten percent within months of the crash. Industrial production fell by approximately 20 percent in the same short time period. Real income was down 11 percent. Peter Temin's systematic study of the economic and market data from 1929-1933 found that the data were consistent with the hypothesis that the market crash caused consumption to drop. His study presented evidence "to suggest that the level of stock-market prices did indeed affect the level of consumption."  

Perhaps most telling of the degree to which the economic impact of the market crash far outdistanced the loss of money in the crash is the extent of the immediate concern by public officials for the possibility of massive unemployment. On November 21, 1929, long before any real financial effects of the crash could have been felt by the macroeconomy, Herbert Hoover began meeting with business leaders to urge them to keep up wages and employment.  

Thus, the causal relationship between the economic crash and the market crash cannot be understood simply as a chain reaction of financial events whereby the crash caused consumers and business to curtail activities directly because of loss of money. The relationship can only be understood if one posits an intervening phenomenon—a failure of public confidence—between the crash and curtailment of economic activity by business and consumers. Nothing else explains the immediacy of the consumer and business reaction to the crash.  

The fact that the confidence of the people had been shaken by the market crash was readily apparent. One Congressman described it as a

137. See id. at 31.
138. See L. Chandler, supra note 109, at 20-21, table 2-1.
139. See W. Stoneman, supra note 67, at vi.
140. Id. at ix.
141. P. Temin, supra note 71, at 45.
142. See J. Seligman, supra note 3, at 5.
“wide-spread doubt and shattered confidence in the business and financial structure of the nation.” 143

That shaking of the national confidence had a predictable and profoundly negative effect on the economy. As Sam Rayburn told the House of Representatives in 1933, “When a people’s faith is shaken in a business the business becomes halting and lame.” 144 The people’s faith in the economic well-being of the nation was shaken in the Fall of 1929, and the economy became lame quickly. The failure of the public’s confidence resulted in a self-fulfilling prophecy of doom. Franklin Roosevelt was correct when, in his 1933 inauguration speech, he laid the blame for the nation’s woes on “fear itself”. Because business and consumers feared that the economy was unsound, they stopped engaging in economic activity. That cessation of activity caused an unsound economy. In Peter Temin’s words, “the initial fall in stock prices helped to depress business, and the overall decline in demand . . . depressed earnings more.” 145 Economic retrenchment led to economic slowdown, which forced businesses to retrench further and to lay off workers. That resulted in still less consumption, and the downward spiral was underway.

The relationship between the market crash and the economic crash thus becomes understandable when we recognize that consumers and business people were shocked into a crisis of confidence. Notwithstanding the relatively slight losses to a relatively narrow slice of the population in the near term, 146 consumers stopped consuming and businesses retrenched immediately. But why? Why was the confidence of consumers and business people so shaken? The economy was still relatively strong, and the economic forecasts were for prosperity. 147 The answer is that because of a lack of a culture of financial information, the public had no cultural basis for believing the available information that showed the economy in general, and publicly held companies in particular, to be basically sound. That is the gravamen of the third proposition.

c. Proposition #3: The crisis of confidence, which caused the market crash to lead quickly to an economic depression, was possible only in the absence of a culture of financial information.

People lost confidence following the crash of 1929 because they either did not pay attention to, or did not view as credible, those indicia showing

144. Id. at 177.
145. P. TEMIN, supra note 71, at 45.
146. See supra notes 130-37 and accompanying text.
147. See supra notes 190-10 and 190-11.
that both the economy and most businesses were strong. The information was there, at least in part. Herbert Hoover could look at the data being compiled and assure the public with confidence that the business of the country—production and distribution—was sound. The numbers showed an economy that was slowing slightly from its hectic pace of the previous few years, but which was nonetheless prosperous. There was no information that would have foretold of the dark days ahead for the economy.

An examination of available information for individual firms would have shown an equally rosy picture. In fact, as Table 2 shows, many firms judged to be among the most sound by the investment services, represented terrific bargains in terms of price/earnings ratios at the end of 1929.

Table 2: High and Low P/E Ratios for Selected Companies, 1929

<table>
<thead>
<tr>
<th>Company</th>
<th>P/E Ratio at 1929 High Price</th>
<th>P/E Ratio at 1929 Low Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Motors (Aa pfd)</td>
<td>17</td>
<td>6</td>
</tr>
<tr>
<td>Youngstown Sheet &amp; Tube (Aa)</td>
<td>20</td>
<td>5</td>
</tr>
<tr>
<td>National Dairy (A)</td>
<td>22</td>
<td>9</td>
</tr>
<tr>
<td>Sinclair Oil (Baa)</td>
<td>16</td>
<td>7</td>
</tr>
</tbody>
</table>

Also, many sound firms dropped to prices that made them tremendous bargains as dividend plays. Table 3 shows the high to which some sound companies' dividend yields reached in 1930.

Table 3: High and Low Dividend Yields for Selected Companies, 1929

<table>
<thead>
<tr>
<th>Company</th>
<th>Dividend Yield at 1929 High Stock Price</th>
<th>Dividend Yield at 1930 Low Stock Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Phillips Petroleum (A)</td>
<td>4.26%</td>
<td>16.67%</td>
</tr>
<tr>
<td>Pillsbury (Baa)</td>
<td>3.13%</td>
<td>8.00%</td>
</tr>
<tr>
<td>Warner Brothers (Baa)</td>
<td>6.15%</td>
<td>30.00%</td>
</tr>
<tr>
<td>Bethlehem Steel (Aa)</td>
<td>4.26%</td>
<td>12.75%</td>
</tr>
</tbody>
</table>

Finally, Table 4 shows that the dividend bargains to be had were industry-wide. Stocks of firms that were, generally, financially strong in
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1929 and early 1930, sank in the aggregate to levels that afforded investors terrific bargains: the average dividend yield of tabulated firms jumped from 2.88% to 7.62% in a matter of months.

Table 4: Average High and Low Dividend Yields by Industry, 1929-1939

<table>
<thead>
<tr>
<th>Industry</th>
<th>Average Yield at 1929</th>
<th>Average Yield at 1930</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>High Stock Price</td>
<td>Low Stock Price</td>
</tr>
<tr>
<td>Railroads</td>
<td>3.57%</td>
<td>7.45%</td>
</tr>
<tr>
<td>Banks</td>
<td>1.42%</td>
<td>4.54%</td>
</tr>
<tr>
<td>Oil</td>
<td>3.45%</td>
<td>7.85%</td>
</tr>
<tr>
<td>Chemical</td>
<td>1.88%</td>
<td>5.40%</td>
</tr>
<tr>
<td>Food</td>
<td>3.16%</td>
<td>7.08%</td>
</tr>
<tr>
<td>Mining</td>
<td>3.60%</td>
<td>9.24%</td>
</tr>
<tr>
<td>Motion Pictures</td>
<td>2.97%</td>
<td>11.43%</td>
</tr>
<tr>
<td>Steel</td>
<td>2.97%</td>
<td>8.00%</td>
</tr>
</tbody>
</table>

One explanation of the data is that investors were simply prescient and quickly foresaw the eventual economic ruin of the public companies represented in the data. In fact, the data are consistent with this view that the market immediately and accurately discounted the earning and yield information. Such an interpretation, however, necessitates assuming that investors had available (and believed) information that indicated disastrously bad times were ahead for the companies whose stocks are tabulated. The market could only have discounted stock price on the basis of available bad news about the future earnings and yields of those companies, and there simply was not that sort of information circulating on a pervasive basis. Indeed, the general consensus among officials and analysts was that the market crash was a mere hiccup in an otherwise sound economy.

If the available information would have led investors, business people, and other members of the public to the conclusion that the economy and individual firms were strong, notwithstanding the crash in the market, and to the conclusion that many of those firms represented substantial bargains in terms of yield and earnings, why did the public at large act so pessimistically concerning the future? The most plausible explanation is that they were not acculturated to rely on such information. Non-informational forces such as greed, blind hope, and speculation that drove the market upward shortly before the crash led to the crisis of information that brought on the depression. This time, however, those non-informational forces were...
fear and uncertainty. The public lacked confidence in a culture of financial information that would have caused it to overcome visceral reactions to the crash and to look instead at the numbers.

This Part has attempted to show that the lack of a culture of financial information can be seen as a lynchpin in the boom and bust of the period from 1928 to 1933. The lack of such a culture made the speculative bubble of 1928-1929 possible and also resulted in the failure of public and business confidence that turned the market crash into a general economic depression. When we look at the years following this period, we see Congress putting in place the groundwork for a future culture of financial information. The existence of that culture, in which we live today, can be seen as the moderating force that is largely responsible for keeping the 1987 market drop from resulting in another depression.

III. Market Corrections in a Culture of Information

A. Federal Securities Law and the Rise of the Culture of Information

In 1933 and 1934, the federal government responded to these informational failures that had been causes of the stock market crash and ensuing depression by enacting the two statutes that form the basis of the regulatory framework for the purchase and sale of securities: the Securities Act of 1933 and the Securities Exchange Act of 1934. Both statutes were designed to make readily available to investors important financial information that investors could rely upon in making investment decisions. The degree to which the two statutes have had their designed effect is striking.

With the 1933 Act, Congress accomplished two goals. First, it made it a federal crime willfully to make misstatements of material fact in connection with the purchase or sale of securities and provided for civil

liability in such cases.\textsuperscript{159} Since then, stock fraud has been illegal throughout
the nation, making it much more difficult for swindlers to operate with
impunity.\textsuperscript{160} The variations in state antifraud laws up to that point had
been an invitation to the inventive perpetrator of stock fraud, who had
developed a panoply of devices to avoid the reach of state law.\textsuperscript{161}

Second, the 1933 Act instituted a system of mandatory disclosure of
financial information applicable to most new issues of securities.\textsuperscript{162} The
worth of a share of stock in an initial public offering will always be a
matter of guesswork and will always be disputed by investors. Congress,
with the 1933 Act, ensured that the raw data necessary for educated
guesswork and dispute would be available to the public.

With the 1934 Act, Congress went even further. That Act sought to
address numerous problems that were thought to be causally connected to

\textsuperscript{159} Section 17(a) of the 1933 Act, 15 U.S.C. § 77q(a) (1982), provides as
follows:

It shall be unlawful for any person in the offer or sale of any securities
by the use of any means or instruments of transportation or communication
in interstate commerce or by the use of the mails, directly or indirectly—
(1) to employ any device, scheme, or artifice to defraud, or
(2) to obtain money or property by means of any untrue statement
of a material fact or any omission to state a material fact necessary in
order to make the statements made, in the light of the circumstances under
which they were made, not misleading, or
(3) to engage in any transaction, practice, or course of business which
operates or would operate as a fraud or deceit upon the purchaser.

\textsuperscript{160} Indeed the prevention of stock swindles was one of the impetuses for
enactment of the 1933 Act. See 77 CONG. REC. 2935 (1933) (remarks of Rep.
Chapman):

[There are no extenuating circumstances when shrewd and crafty men,
skilled in the tricks of a crooked game, sit around a table and deliberately
and premeditatedly plan, and ruthlessly execute the plan, by devising
cunning schemes and resorting to every conceivable trick of financial
legerdemain, to loot an unwary public of millions of dollars earned by
the sweat of the brow. Such criminals ought to be held not only to full
civil responsibility but also to full criminal responsibility, as provided in
this bill.

\textsuperscript{161} By 1933 every state in the country except Nevada had a securities law.
However, as early as 1915 the Investment Bankers' Association was counseling its
members on how to avoid state regulation by selling across state lines. Additionally,
industry associations such as the IBA had succeeded in diluting the strength of
many state securities laws by lobbying for gaping loopholes. See J. SELIGMAN, supra
note 3, at 45-46.

\textsuperscript{162} Section 5(a) of the 1933 Act, 15 U.S.C. § 77e(a) (1982), prohibits sales
of securities by any person unless a disclosure document referred to as a registration
statement is filed with the SEC and declared effective. In sections 3 and 4 of
the 1933 Act, 15 U.S.C. §§ 77c-77d (1982), Congress provided numerous exemptions
from registration.
the 1929 stock market crash.163 Most importantly, the 1934 Act extended the mandatory disclosure requirements of the 1933 Act to relatively large publicly held companies,164 ensuring that the worth of existing companies’ shares could be evaluated by investors. In addition, the 1934 Act provided for restrictions in the availability of credit to finance securities purchases,165 a provision that sought to restrain speculative bubbles166 and prevent the absorption by the securities markets of an undue share of the nation’s credit resources.167

As a result of those two Acts, an investor today has the raw data to evaluate nearly any company in which he or she is considering buying stock.168 Today any company or individual that wishes to distribute securities to the public must either disclose much information about itself by filing a registration statement under the 1933 Act or must find an exemption within that Act.169 In addition, any company that has at least 500 shareholders and more than $5,000,000 in assets must make similar disclosure about itself under the 1934 Act.170 The result is the ready availability of


164. See infra note 170 and accompanying text.


166. As one committee report phrased it, "There can be little question that stock-market speculation is among the most potent of the factors which have contributed to the prolonged depression." Report of the Senate Committee Banking and the Currency, S. Rep. No. 792, 73d Cong., 2d Sess. (1934), reprinted in 1 FEDERAL SECURITIES LAW—LEGISLATIVE HISTORY 1933-1982, at 710 (1983). The report then went on to point out that freely available margin was partially to blame for the speculation: "The evidence submitted to the committee by experts on the staff of the Federal Reserve Board has indicated that uncontrolled speculation on security markets was an important cause of the credit inflation which led to the collapse of 1929 and the subsequent depression." Id.

167. See id. "Banks diverted their credit from agriculture, commerce and industry to the stock market where it contributed to the over-expansion of big enterprises, largely engaged in interstate commerce." Id.

168. This is not to say, of course, that investors have equal access to that information or that investors are equally situated to take advantage of the information once gained. Those sorts of informational disparities are, however, beyond the preview of this essay.

169. See supra note 157.

170. Section 12 of the 1934 Act, 15 U.S.C. § 78l(g) (1982), requires registration under that act of the securities of any company with at least 500 shareholders and more than 1 million dollars in assets. That section also authorizes the SEC to raise the threshold for registration and reporting. Id. at § 78l(g)(5). The SEC has done
basic financial information concerning nearly any company an investor is likely to be considering.

More systemically, as a result of the federally mandated disclosure, and restrictions on other sales techniques, there arose the culture of financial information in existence today. All companies desiring to sell nonexempt securities must not only make disclosure, they must make the same type of disclosure other similar firms must make, and all such firms must make the sort of disclosure mandated by the SEC. Further, because of the huge potential civil liability for materially false or misleading statements or omissions in both the 1933 and 1934 Acts, those who disclose have strong incentives to make certain the information is neither incomplete nor false or misleading.

The result is that investors have massive amounts of reliable information concerning publicly held companies. Because that information is there in sufficient quantity and is sufficiently reliable, investors have in fact come to rely on that information. The reliance is not always direct, of course. Large sophisticated investors place a great deal of reliance upon the information directly, but small investors are more likely to rely on the reports of sophisticated investors, investment analysts (including financial media), and the integrity of the market itself to price securities accurately on the basis of available public information.

This is the culture of information. Investment decisions today are made primarily (although certainly not always) on the basis of information, derived directly or indirectly from the disclosure made under the mandate of the federal securities laws. It was that culture of information that held in check the boom in stock prices that occurred in the summer of 1987 and prevented a crisis of confidence that might have caused the market correction in October of 1987 to result in a serious economic downturn.

B. Market Pricing Within a Culture of Financial Information

There is always a certain amount of speculation in the pricing of securities, but the bull market in equities that began in the early 1980s has not been, and was not in 1987, a classic speculative bubble in the same way as was the 1928-1929 runup in stock prices. When we speak of "speculation" in its pernicious form, we use the term in its literal sense: the pricing of securities not based on economic reality. In that sense, speculation is the bidding up of prices without attention to the underlying value or earnings capacity of the company that issued the securities.

In 1987, everyone knew on a daily basis what the most recent earnings for any given company were and could continually make his or her own
judgment about whether a given security was sporting too high a price/earnings multiple. In short, the bidding up of prices in the early and mid 1980s was a knowing one; the speculation of the 1920s was blind.

The predictable effect of this ongoing knowledge by investors was a rise in security prices in 1987 that was much more closely tied to reported earnings of the companies whose stock was being traded. Whereas the average price/earnings ratio in 1929 reached the level of 30,\textsuperscript{171} the average P/E multiple for S & P 500 stocks in 1987 reached only approximately 22,\textsuperscript{172} a difference of roughly 27 percent.

In a very real sense, then, one can see the existence of this culture of information as one reason the market rise in 1987 was not as steep in relation to underlying values, as the rise in 1929. The 1987 rise was not speculative; it was knowing. Thus, it did not have the capacity to get out of hand. Investors today, acculturated to information-reliance to a degree they were not in 1929, are more tied to financial reality than their counterparts in the 1920's. The rise of the culture of financial information, of which federally mandated disclosure is an important part, is the reason.

C. The Importance of Information in Market Downturns

Just as the rise in stock prices in 1987 was not as speculative or frenzied as it had been in 1929, the downturn in 1987 was much less debilitating than the crash of 1929. There is an irony in that fact, since the drop on October 19, 1987 was much more severe both in real and percentage terms than the drop on October 28, 1929.

The stock market had, in the summer of 1987, been climbing rather steadily since the recession of 1982. The Dow Jones Industrial Average (DJIA) peaked at 2722 on August 25, 1987.\textsuperscript{173} From then on the pattern followed closely the period from September 1 to October 28, 1929. The market in 1987 fell slowly but steadily throughout August and September. On October 1, 1987, the DJIA stood at 2639.20.\textsuperscript{174} On the Thursday and Friday before October 19, the Industrial Average fell approximately 150 points, to close at 2246.12.\textsuperscript{175}

On Monday, October 19, the DJIA fell exactly 508 points, losing approximately 22.5 percent of its value. That loss also put the market down more than 36 percent from its August high. There was then a rebound as bargain-hunters stepped into the market. The market fluctuated wildly over a period of several weeks and eventually settled into a trading range between 1900 and 2000 by the end of the year.

\textsuperscript{171} See B. Wigmore, supra note 68, at 27-28.
\textsuperscript{172} See Wall St. J., Oct. 18, 1988, at Cl, col. 1.
\textsuperscript{173} See Greenwald & Stein, supra note 105, at 3, 5.
\textsuperscript{174} See 4 OTC DAILY STOCK RECORD, PART I (Oct.-Dec. 1987).
\textsuperscript{175} See id.
Notwithstanding the similarities in pattern, one must view the two precipitous drops in the equities markets differently. The crash of 1929 was a disaster—inevitable, but a disaster nonetheless. Its necessity was caused by a speculation only possible because investors had no way of knowing they were bidding stocks too high. It was a crash in the true sense: the implosion of a burst speculative bubble.

The term "correction" is overused, but it, more accurately than "crash," describes the drop in securities prices in mid-October 1987. The market effectively said: "We've been watching this market go higher and higher, and we have watched the average P/E ratio get higher and higher, and now we think stocks have simply gotten out of line with underlying values." Notice that such a statement could not have been made by a market participant in 1929, since he or she would not have been trading on the basis of companies' P/E ratios or underlying asset values.

But in 1987, the market did say that, and corrected itself. Unfortunately for many short term traders, the market said it loudly and quickly. But, the drop was not the bursting of a bubble; in fact, as already mentioned, the increase in prices that preceded October 19, 1987 was not a speculative bubble at all. And there was no bursting. In a burst, panic sets in and sales are made in no relation to underlying values or earnings.

It is true that automatic program trading lent an element of irrationality to the massive number of sell orders placed on October 19, 1987, and it is also true that the program trading exacerbated the correction of that day. Further, because the electronic ticker tape fell so far behind due to the unprecedented volume of shares being traded, investors were temporarily unable to ascertain what the market price was for certain shares. In addition, many individual investors were shut out of the markets during the most hectic days—October 19 and 20—by their inability to reach a

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176. Program trading involves the computerized arbitrage of slight differences in price between stock index futures and baskets of stocks that make up the index for which the future is traded. In one sense, program trading is irrational in that the computer (rather than a human mind) makes the trading decision. On the other hand program trading can be viewed as the ultimate in rationality, since decisions are made solely on the basis of objective facts.

177. Program trading that arbitrages price discrepancies between stocks and stock index futures can have the effect of causing volatility in the markets simply because of the huge quantities of stocks that are being sold. If one wants to arbitrage a price discrepancy between the value of the stocks in the S & P 500 and futures contracts on the S & P 500 index, one might sell a basket of stocks representing the S & P 500 in order to purchase a matching index future. That massive sale of the S & P 500 stock can cause sell volume to rise dramatically in relation to buy volume and thus drive the price of stocks in the S & P 500 down sharply. On October 19, 1987, there were many such trades, with the result being unprecedented selling pressure on the S & P 500 stocks and therefore unprecedented losses in those stocks.
broker. The phone lines were busy constantly. But the point remains: all investors had the raw data—both macroeconomic and firm-specific—necessary to provide a rationality to their decisions whether or not to sell. The crash of 1987 therefore was not wholly divorced from reality the way the crash of 1929 was.

Not only did the culture of financial information give a different character to the break in stock prices, it also made the economic consequences of the break completely different from that experienced in 1929. In comparing the economic effects of the two breaks, we find that the most recent decline, unlike its 1929 counterpart, has had almost no adverse economic effect on either the market or the economy as a whole. The stock market trend following the 1987 drop was much more positive than the 1929-1930 trend. One year after the crash of 1929, the market was still down more than 34 percent compared to its level immediately before Black Monday. One year after the 1987 drop, the market was down less than four percent compared with its level immediately before the break. If the market were to follow its 1930's trend, the Dow Jones Industrial Average would close out 1989 at 587—not likely in anyone's forecast. If such a drop were to occur, it would be for reasons completely unrelated to the drop in October 1987. The stock market has all but forgotten about October 19, 1987.

So has the economy generally. Businesses have continued to transact business. Capital spending has increased substantially, orders for durable goods have risen strongly, corporate profits are higher, and unemployment has moved modestly lower. In Richmond, Virginia, for example, a year after the 1987 dip saw a booming economy. Factories were operating

178. Pointing to factors such as these, Greenwald and Stein have concluded that "from the mid-afternoon on October 19 until the late afternoon on October 20, equity markets became separated from any stable economic reality." Greenwald & Stein, supra note 105, at 3, 13.

179. Leland and Rubinstein concluded recently that "unlike the October 1929 crash, the 1987 crash did not presage a general economic downturn." Leland & Rubinstein, supra note 2, at 45.

180. The day before Black Monday, the DJIA stood at 298. One year later, it stood at 195. See THE DOW JONES AVERAGES, 1885-1985 (P. Pierce ed. 1986).


182. The Industrial Average fell to 77.90 at the end of 1931, a loss of nearly 74 percent from its level immediately before the crash. See THE DOW JONES AVERAGES, 1885-1985 (P. Pierce ed. 1986).


185. See id.

186. See id.

at or near capacity;¹⁸⁸ unemployment had sunk to approximately 3.2 percent;¹⁸⁹ and employment levels were at an all time high.¹⁹⁰ Industrial companies continued to invest millions of dollars in new plants and equipment.¹⁹¹

And consumers nationwide have continued to consume. In fact, U.S. Department of Commerce figures show that retail sales are up since the market downturn. In September, 1987, retail sales, seasonally adjusted, amounted to 128.8 billion dollars; a year later, that figure was 133.7 billion dollars.¹⁹² Gross National Product is up¹⁹³ and real G.N.P. growth has continued to be strong.¹⁹⁴ A recent study suggests that in the year of any stock price decline, consumer spending falls, on average four cents for every dollar’s worth of decline in stock values.¹⁹⁵ Indeed, as pointed out above, that sort of consumer spending drop was a significant cause of the depression of the 1930’s.¹⁹⁶

If the drop in securities prices in October of 1987 was more severe in both real and percentage terms than the drop in October of 1929, why did the 1987 drop not result in a worse economic slump than that experienced in 1929? One recently constructed economic model would predict that consumer spending would drop nearly $40 billion dollars in 1988, yet that did not occur.¹⁹⁷ Why not? There are several plausible explanations, although economist David Runkle has suggested that the rise in consumer spending following the most recent setback in the stock market is baffling given consumers’ historical reaction to stock market declines.¹⁹⁸

One improbable explanation for the difference in the economic reaction to the two market declines is the increased margin requirements of 1987 compared to 1929. Although it is true that margin requirements under the Federal Reserve Board’s Regulation T are higher than those existing for much of the 1920’s,¹⁹⁹ in 1987 there were other common tools of leverage such as index options and index futures that had the same effect as margin in the 1920’s.²⁰⁰ In addition, the problem of margin calls in 1929 was

¹⁸⁸. See id.
¹⁸⁹. See id.
¹⁹⁰. See id.
¹⁹¹. See id.
¹⁹³. See id.
¹⁹⁴. See id.
¹⁹⁶. See supra notes 116-150 and accompanying text.
¹⁹⁷. See Runkle, supra note 2.
¹⁹⁸. See id. at 7.
²⁰⁰. For an excellent and concise explanation of the relationship between stocks, stock indexes, and stock index futures, see Greenwald & Stein, supra note
probably more apparent than real, since there were only approximately 600,000 margin accounts in existence at the time of the crash.\textsuperscript{201} Thus, the tightened margin rules alone cannot explain the difference.

A more plausible, although incomplete, explanation is that Federal Reserve Board Chairman, Alan Greenspan, announced on October 20, 1987 that the Fed would ensure the availability of sufficient funds to keep the financial system liquid.\textsuperscript{202} But that cannot be the entire answer. The depression of the 1930's did not come about only because there was a liquidity problem;\textsuperscript{203} the biggest problem in the 1930's was that consumers and businesses ceased economic activity for lack of confidence after the crash.\textsuperscript{204}

Another possible explanation is the difference in consumer psychology in 1987 in comparison with 1929. Perhaps consumers in 1929 would only consume if they knew the money was there, whereas a 1980's consumer would consume even when the money was not there, simply by using more credit. Perhaps, also, consumers operated in 1987 under the implicit assumption, brought about by the rise of the Welfare State and therefore not present in 1929, that Government would not let the crash wipe them out. These suppositions are difficult to substantiate, but they may have played a part in ensuring that consumers would continue to consume in 1987 in quantities they did not in 1929. But these psychological speculations cannot explain continued business expansion and probably would not account for the extent of the continuation of consumer spending. Surely not all consumers would operate with the psychology described above, and if some would not, we should have seen some slowing down of consumption. Yet, we did not.\textsuperscript{205}

The most plausible explanation for why the most recent market decline did not presage a general economic decline is that that the lynchingpin in the causal connection between the 1929 crash and the great depression was missing in 1987. Consumers and businesses did not cease economic activity. Why did they not cease buying and spending the way they did in 1929? Because they did not lose confidence in the economy. Why did they not lose confidence in the economy? Because they were acculturated to look at the numbers, in a way they were not in 1929, and could see that the economy was strong and that it was likely to continue to be strong. Why were they acculturated in that way? Because following the crash in 1929, Congress put into place a mandatory disclosure system that gave rise to a culture of financial information.

\textsuperscript{201} See supra note 129 and accompanying text.
\textsuperscript{203} See B. Wigmore, supra note 68, at 91-101 (arguing that money supply and the role of the Federal Reserve Board cannot adequately explain the crash).
\textsuperscript{204} See supra notes 130-147 and accompanying text.
\textsuperscript{205} For other possible explanations, see Rohatyn, Institutional "Investor" or "Speculator"? Wall St. J., June 24, 1988, at 18, col. 4.
IV. Conclusion

This article has attempted to answer the question: what was different about 1987 in comparison to 1929 that would explain why the market crash in 1929 led to a depression but the correction of 1987 did not. I have suggested that there was a causal chain at work in 1929 that led to the depression and that one of the links in that chain was missing in 1987. Further, this article has attempted to show that the essential link between the market crash and the depression sixty years ago was pulled out by Congress when it enacted the Securities Act of 1933 and the Securities Exchange Act of 1934. That essential link was the absence of a culture of financial information.

The speculative bubble that formed in 1929 likely would not have occurred had investors been acculturated, then, to rely upon financial data. In fact, when stock prices rose in 1987 after investors had been so acculturated, they did not rise nearly as high. Then, when the market crashed in 1929, the confidence of both consumers and businesses was shattered even though available data showed the economy to be strong. That crisis of confidence likely would not have occurred had the public been acculturated to make decisions based upon available financial data in which they believed. In fact, when a more severe break in the market occurred in 1987 after the rise of the culture of information, the public did not lose confidence.

In short, both the action (the rise in stock prices) and the reactions (the decline in stock prices and subsequent economic decline) have been tempered in the 1980s in a way they were not in 1929. The tempering force, the factor most responsible for the difference between the two events, has been the rise of a culture of financial information. The impetus for that culture came in the early 1930’s in the form of the federal system of mandated financial disclosure by publicly held companies. As a direct result of that system, we have seen a market correction without meaningful lasting macroeconomic effects, instead of a crash followed by a worldwide depression.

Thus the market downturn of 1987 can be seen as an affirmation of the efficacy of the federal securities laws, at least to the extent that those laws require disclosure by publicly held companies. What is startling about that conclusion is that it shows that the federal securities laws have worked approximately the way they were designed to work. What is perhaps even more startling is that their efficacy in the manner designed is surprising.

Neither regulation nor deregulation is inherently good nor inherently evil. Government regulation can be unnecessary, overbearing, intrusive, inefficient, and even debilitating. But government can also do good and beneficial things, not only for individuals but for the economy as a whole. The lesson of the recent stock market correction and what it tells us about our federal securities regulation system is a lesson we might remember in contemplating the proper relationship of government to the economy.