



1943

## Some Ethical Aspects of Stock Market Operations

Walter G. Becker  
*Loyola University Chicago*

Follow this and additional works at: [https://ecommons.luc.edu/luc\\_theses](https://ecommons.luc.edu/luc_theses)



Part of the [Philosophy Commons](#)

---

### Recommended Citation

Becker, Walter G., "Some Ethical Aspects of Stock Market Operations" (1943). *Master's Theses*. 3452.  
[https://ecommons.luc.edu/luc\\_theses/3452](https://ecommons.luc.edu/luc_theses/3452)

This Thesis is brought to you for free and open access by the Theses and Dissertations at Loyola eCommons. It has been accepted for inclusion in Master's Theses by an authorized administrator of Loyola eCommons. For more information, please contact [ecommons@luc.edu](mailto:ecommons@luc.edu).



This work is licensed under a [Creative Commons Attribution-Noncommercial-No Derivative Works 3.0 License](#).  
Copyright © 1943 Walter G. Becker

SOME ETHICAL ASPECTS OF STOCK MARKET OPERATIONS

BY

WALTER G. BECKER, S.J.

A THESIS SUBMITTED IN PARTIAL FULFILLMENT OF  
THE REQUIREMENTS OF THE DEGREE OF MASTER  
OF ARTS IN LOYOLA UNIVERSITY

FEBRUARY

1943

## VITA

Walter G. Becker was born in Chicago, Illinois, on July 6, 1911.

He was graduated from St. Mel High School, Chicago, in June, 1929, and for the next seven years was employed in the Chicago office of Messrs. S. B. Chapin & Co., stock brokers. During the same period he attended the Northwestern University Evening School of Commerce for five semesters, and the Chicago Stock Exchange Institute for one semester.

In September, 1936, he was admitted into the Society of Jesus, and was enrolled in the Milford Division of Xavier University, Cincinnati, Ohio, where he remained for two years. In September, 1938, he was enrolled in West Baden College of Loyola University, and there received the degree of Bachelor of Arts with a major in economics in February, 1940. The next three semesters he devoted to graduate studies in the department of philosophy.

Since September, 1941, he has taught English, Latin, history, and ethics in the University of Detroit High School.

TABLE OF CONTENTS

Page

INTRODUCTION . . . . . iv

Basic misunderstanding -- Purpose of thesis --  
Terminology and method.

CHAPTER

I. THE STOCK EXCHANGE AS A MARKET . . . . . 1

Origin and development -- The perfect market --  
The single price -- Organization and control --  
Necessity of monopoly -- Responsibility of members.

II. MARGIN TRADING AND SHORT SELLING . . . . . 10

Mechanics of margin trading -- General misunder-  
standing -- Its intrinsic nature -- Short selling  
and the grain exchanges -- Hedging and risk bear-  
ing -- Short selling in stocks -- Its abuse and  
ethical nature.

III. REGULATION OF THE STOCK EXCHANGE . . . . . 23

Over-expansion of speculation -- Reform by the  
Exchange -- Securities and Exchange Commission --  
Margin requirements -- Reduction in speculation --  
Short selling -- Results of regulation -- Other  
unethical practices.

IV. SOME LARGER ASPECTS OF REGULATION . . . . . 39

Usefulness of speculation -- good and bad specu-  
lation -- Example of the Berlin Stock Exchange --  
Gold speculation in America -- Suppression and  
regulation of exchanges -- limitation of specu-  
lation under the SEC -- Efforts of individual  
states.

CONCLUSION . . . . . 54

BIBLIOGRAPHY . . . . . 60

## INTRODUCTION

There is, perhaps, in our whole economic system no institution which has been so bitterly attacked and so stoutly defended as the stock exchange. Those who are employed in connection with it and those who make money on it (or hope to) extoll it as the typically American institution where opportunity waits to be grasped by the clever and aggressive. Reformers of all types and their sympathizers condemn it as a gambling den and the center of selfish Wall Street control of the finances of the nation. To examine and evaluate all these points of view being a work of too wide a scope, the present writer will attempt to analyze only the more important ones. Those chosen are the following: the attitude of unqualified approval as represented by J. Edward Meeker, official economist and apologist of the New York Stock Exchange; the frankly critical view of, for example, John T. Flynn, the debunker of "benevolent big business and high finance" myths; and the more moderate and analytical viewpoint of Msgr. John A. Ryan, one of the most outstanding Catholic economists and ethicians. In the course of the work various other writers will be cited, but these three seem to represent extraordinarily well their respective schools of thought, and taken together have put down all the principal arguments pro and contra the stock exchange.

In order to simplify this treatment and make it more definite, the New York Stock Exchange will be used to typify all the exchanges of the country, since it is the prototype and the one which all the others admittedly try to imitate. Foreign exchanges have been excluded because their different methods of doing business and their various positions in the financial life of their respective countries would only confuse the issue. However, mutatis mutandis, the main conclusions of this thesis should apply to them also. Likewise, it was thought well to omit an analysis of the grain exchanges, and to confine the discussion solely to the stock market. This rule is followed except in the consideration of short selling, where the hedging operations in grain throw considerable light upon the corresponding operations in stocks, by way both of similarity and of contrast.

The purpose of this thesis is to examine the stock exchange and its operations from an ethical point of view in order to determine whether or not they occupy a legitimate position in our modern economic life. In this sort of study it is necessary, of course, to proceed step by step, first analyzing the stock market in se, determining whether or not it is a natural and necessary growth, or one which has been fostered for the selfish interests of a few speculators. In the second chapter are considered two of the most mooted practices of the exchange, margin trading and short selling. These, also, will be examined in themselves and without regard to the abuses to which

they may have given rise. To adopt this procedure is not to deny the abuses which have undoubtedly crept in, nor is it to deny the necessity of abolishing practices which, although good in themselves, have become hopelessly corrupt. It is only when things are distinguished from their misuse that a clear picture can be had of them, and judgment can be made whether or not their abuse is inextricably linked with their use. In the third chapter this whole question of the abuse of stock exchange practices is taken up in the light of the work of the Securities and Exchange Commission. Many, with seemingly solid reasons, have urged that the stock exchange be suppressed as a hopelessly corrupt institution, whose members are too crafty and whose procedure is too complicated ever to be reformed at all. The task, indeed, has been difficult and involved, but the Securities and Exchange Commission has set about it with fearlessness and ardor, and the result is a good argument for the reformability of the exchange. In the fourth chapter are considered the wider economic and social implications of widespread speculation both before and after the advent of the SEC.

No attempt will be made to treat in an exhaustive manner every ethical aspect of the exchange and its practices. A mere glance at the rules and regulations of the SEC will make evident the impossibility of such a course. Rather the attempt will be to examine thoroughly the more salient and disputed points and the larger aspects of the question.

To one trained in scholastic philosophy the lack of the

terminology of the schools in an analysis professedly from the scholastic point of view may seem a bit disconcerting, but it is hoped that the necessary ideas are expressed clearly, even though they be in modern form. Since this thesis was written not only for scholars but also for the perusal of the "average" business man, it is expressed in terms which he will understand, and its ethical judgments are based upon norms which he will admit. These norms, therefore, are rather proximate, and are not reduced to the more fundamental ones which might be termed more philosophical. Not for that reason, however, should they be any less valid and objective. One of the frequently used criteria, for example, is that of "naturalness". Since most economic operations are wholly indifferent in themselves, they must be judged mainly from their effects upon individuals or the community at large. Such are most processes which grow up, as it were, by reason of the very exigencies of the situation, or in other words, in a "natural" manner. An example of this would be the wholesale grocery business. The small retailer, occupied with his customers and buying in meager quantities, needs someone who can contact the large producers, buy their goods in large quantities, and then break them up into small lots for distribution. Thus the wholesaling of groceries is a legitimate business because it grows up naturally through an exigency of the economic process of distribution, and because it benefits some and per se injures none. The phrase "injures none" must be taken in the social as well as in-



dividual sense, since an institution which may provide a living for a number of individuals and may directly injure no one, may yet be an unnatural and harmful growth in the social body as a whole inasmuch as it may be wholly useless, and thus would retain the energies of its operators from more socially useful production. This is a charge commonly made against the stock exchange, and will be considered in detail in the last chapter.

The word "useful" is to be taken merely in the sense of a means toward the attainment of some good or indifferent end. And since the procuring of the means of livelihood for the individual and the expansion of production, especially in the modern world of underconsumption and unemployment (speaking of pre-war conditions), are good and desirable, they are used as valid criteria in the ethical evaluation of economic institutions and practices.

Another method which should prove useful toward making clear the essential nature of the exchange and its practices and toward freeing them from the obscurity arising from their complex nature, is to compare them with the more common and completely understood transactions of daily business life, especially those whose legitimacy is never questioned. Thereby is eliminated the greatest difficulty under which controversy over the stock exchange labors -- a failure to grasp what is the state of the question.

## CHAPTER I

### THE STOCK EXCHANGE AS A MARKET

In order to understand fully the nature of the stock exchange and its position in the economic set-up of today, it will clarify matters greatly to consider its origin and development. For this institution has grown so large and complex in the mere physical mechanism necessary to carry on its business that its essential nature has been greatly obscured except to the discerning economist. Some have even condemned it on the score of complexity alone, arguing that such an elaborate system of clerks, offices, tickers and other paraphernalia is uneconomic and wasteful for the simple transaction of transferring shares of stock. But a brief glance at the history of the exchange will reveal that all its present complexity, or at least the greater part of it, was introduced gradually by force of circumstances, and generally to prevent the creeping in of abuses.

The institution known today as the New York Stock Exchange had its beginning on May 17, 1792 in an agreement signed by twenty-four brokers of New York City binding themselves to give preference to each other in their negotiations and to establish a minimum commission of one-quarter of one percent. At first all trading was done under an old buttonwood tree at 68 Wall St. and it was not until 1817 that a room was hired in which to

conduct trading. As the volume of business increased, it was found necessary to replace the informal trades performed at the leisure of the individual brokers by having the President call the various stocks singly from time to time in order that all wishing to trade in any particular stock might do so together and at the same time. The pre-Civil War expansion of the railroads soon brought large issues of these securities to the Exchange, and constantly necessitated ever stricter and more elaborate procedure in handling the individual transactions. In 1867 the electric stock ticker was introduced to give speedier and more accurate quotation service both to New York City and, later on, to all the distant cities of the United States and Canada. In 1878, in order to allow of more rapid communication between members on the floor of the Exchange and brokers' offices, telephones were first installed, and similarly, telegraph lines soon spread out from New York to all the other centers of investment funds throughout the country. <sup>1</sup>

All these improvements, and many lesser ones, devised by the business man's ingenuity aided by the advance of technology, at length produced an institution which is probably the most bewilderingly complicated of any in the modern economic world. It is not surprising, therefore, that the amateur economist, overlooking the trading floor of the Exchange from the visitors' gallery, and watching a thousand or more persons rushing

<sup>1</sup> J. Edward Meeker, The Work of the Stock Exchange, Revised Ed., Ronald Press Co., New York, 1930, 63 sq.

around like mad -- shouting quotations, waving hands, and dashing to the innumerable telephones which line the walls -- it is not surprising that such a person should decide that here is the simple economic transaction of exchange of goods gone mad with complexity, which, he may suspect, is contrived for the sole purpose of impressing and overwhelming the unsuspecting investor. In a word, it looks more like a giant casino at Monte Carlo than a place for staid appraisal and evaluation of sound business enterprise. <sup>2</sup>

However, all this machinery of exchange has been found necessary to achieve what economists call the "perfect market", which is found nowhere else but in the organized exchange. A perfect market is one in which there is always only one price for any given item at any one time, and in which all buyers and sellers are in continuous communication with one another, and have complete information concerning everything pertaining to market conditions. <sup>3</sup> The first condition is accurately fulfilled on the stock exchange, although only in recent years was it able to devise a means of getting a uniform "opening" price on active securities. The second condition is in large measure fulfilled by the inter-city wire connections of the brokers. The individual buyer in a distant city has no personal contact,

<sup>2</sup> -----  
For a detailed exposition and evaluation of the mechanics of Exchange operations, consult Meeker, op. cit., Chapters I to VI, and XV to XVII.

<sup>3</sup> Fred R. Fairchild, Edgar S. Furniss, and Norman S. Buck, Elementary Economics, Macmillan Co., New York, 1926, I, 285.

of course, with the one who sells to him, but his agent, the broker on the floor of the Exchange, is, as concerns everything pertaining to the market, in touch with every other buyer and seller. The third condition, that of complete knowledge of the market, can never be verified anywhere, but nowhere else are such comprehensive efforts made to keep participants informed of market conditions. Passing over the periodic reports which the Exchange requires to be published by all corporations whose stocks are listed, we may mention the "ticker" service, which publishes every transaction over the whole country within ten minutes of its consummation. Thus, although the Stock Exchange does not attain to all the requisites of a perfect market, "the closeness of the approach ..... would surprise the uninitiated." <sup>4</sup>

These few considerations supply the basic material where-with an approach can be made to the ethical position of the stock exchange in the modern American economic set-up. First of all, practically no one today will deny the legitimacy of the corporation in present-day society, and moreover, it is outside the scope of this study to establish such a legitimacy. It is not to be denied that drastic regulation and even reorganization of big business may be necessary; but if private ownership is to remain a part of our national economy, it is difficult to see how it can be maintained except through the distribution of shares of stock into the hands of individuals.

-----  
<sup>4</sup> Ibid. 286.

And most economists would say the wider the distribution the better. Now, it is this wide distribution of stock that calls for some sort of market for their exchange, for the exercise of the right of ownership includes the freedom to dispose of all acquired holdings at will.

So far there appears no difficulty. But the nature of corporation securities makes for a kind of market with which the average man, and even the average business man, is totally unacquainted in his daily commercial transactions. For shares of stock of the same "class" in any given company are entirely and exactly homogeneous -- a condition which obtains in extremely few markets in the world. The metal, grain and commodity markets, it is true, trade in standard grades, but when it comes to actual delivery, allowances must be made for variations from the standard. And in ordinary commercial transactions, both wholesale and retail, variations in quality must be carefully watched for and accurately appraised. Hence, the market for by far the largest number of commodities and articles bought and sold in the business world, is conducted in a more or less personal way, i.e., by contact of the buyer with the seller in such a way that the concentration of all buyers and sellers in one place, especially for continuous trading, is practically impossible. But the buying and selling of corporation securities is entirely different. Here, any share of General Motors common stock is exactly identical with every other share of the same stock, and so the buyer has merely to specify his prefer-

ence and leave the rest up to his agent or broker. As a result of this characteristic, the buyers and sellers of corporation shares have inevitably gravitated to one place, where the buyers may most easily find sellers, and sellers buyers.

Naturally, under this system of supply and demand, one of the distinguishing features of the "perfect" market is to be found -- that of only one price for any item at any given time. And it must be remembered that the word "perfect" is used here by the economist chiefly in an ethical sense; a perfect market is one in which a fair price is arrived at by free competition among all participants, who all have equal and adequate knowledge of market conditions. The centralized market, therefore, assures one condition of a fair price -- that no one be charged more than another for the same commodity at the same time. The justification of this feature of the stock exchange needs no further elucidation at this time from the viewpoint of the ethics of the just price. Its saving to the individual is quite evident to the business man who must consume much time in comparing bids and prices before buying. Its social saving is sufficiently demonstrated by a consideration of the waste involved both in the "shopping around" of the wary and the inveigling of the unwary.

One of the features of the stock exchange, however, which greatly obscures its economic function is that of its complicated and elaborately technical machinery of operation, which tends to give the exchange the appearance of a glorified Monte

Carlo rather than the dignified air desirable in a financial institution, such as is found, for example, in a large bank. To investigate and justify this machinery would require the services of a trained efficiency expert, and hence would fall outside the scope of this thesis. Suffice it to say, that during the past thirteen years, when the exchange and its members, for lack of business, have been forced to retrench to an extent which would have been believed impossible in the twenties, the number of employees has been drastically cut, but not one of the departments was eliminated or consolidated.

The next point to be considered is the organization and control of the Exchange, since, although the legitimacy of the market itself may be beyond doubt, yet the particulars of organization and business methods may be open to question. The New York Stock Exchange is an association of some 1100 members, each of whom owns a "seat" on the Exchange, and who may trade for themselves exclusively, or act as brokers for others in several different ways (each of which will be considered separately hereafter), or do both. The original agreement, signed in 1792, contained two principal provisos -- that the contracting parties give each other preference in their dealings, and that they adhere to a minimum commission. Since that time, the rules and regulations have expanded to include methods of doing business and the treatment of customers with regard to margins, statements, etc., but the two original clauses are still the most important. The Exchange now prescribes a strict scale of com-



missions from which no member may depart except under penalty, and has restricted the buying and selling of "listed" securities so as to prohibit trading in them by its members anywhere but on the floor of the Exchange. Such legislation practically establishes a pure monopoly since the effort and difficulty of finding a buyer for a certain number of shares, especially an "odd lot" (any fraction of 100 shares), are practically insuperable. Here and there in outlying financial centers there is a certain very small amount of trading done "over the counter" (i.e., between individual and individual or firm and firm, but directly and not through any organized exchange), but generally the inconvenience is not worth the trouble of making arrangements as to delivery, payment and transfer of stock, all of which are cared for automatically by stock exchange regulations.

As has already been pointed out, the gravitation of the buying and selling of corporation shares to one central market is quite natural and inevitable, and it is but one more natural step to the control of this market by a monopolistic association. To one who has watched trading on the floor of the Exchange, it will be evident what a large amount of business is handled by a comparatively small number of men, and to one familiar with the procedure of buying and selling it will likewise be evident what experience and business integrity are necessary for the conduct of the business. The various brokers gather around the "post" at which the particular stock in which they are interested is traded, and bid or offer, as the case may be. Every

trade is consummated by mere word of mouth or even a nod of the head, which because of the volume of business to be done, is all that there is time for. No written contract whatever is exchanged, and the only check-up made is done at the clearing house when the slips turned in by buyers and sellers are matched against each other. The matching, however, is continuous throughout the day, and in normal business times is accomplished within a half-hour after the trade is made. Such a procedure requires that each man allowed on the trading floor be both responsible for all the commitments which he may make, and experienced enough to trade expeditiously and accurately, since in the excitement which always characterizes operations it is very easy to make a mistake. Therefore, the only way business can be done is by means of a highly-restricted group; restricted in numbers in order to keep the total within what a reasonable trading area can supply space for, and restricted in financial standing to those who can furnish a bond (in the form of a deposit with the Stock Clearing Corporation) sufficient to guarantee all their contracts. This latter provision is of the utmost importance in a market which demands implicit confidence among its members, since trading is done with no discrimination of persons. Even if one broker were suspicious of the financial condition of another, he could not by rule avoid doing business with him. The stock exchange, therefore, is of necessity a pure monopoly and highly exclusive organization, and only as such can it safeguard and foster its own and the public interest.

## CHAPTER II

### MARGIN TRADING AND SHORT SELLING

Two of the most controverted practices on the exchange are short selling and buying on margin. Since short selling is also done "on margin", the buying transaction will be examined first. Throughout the discussion it must be kept in mind that the purpose of this chapter is solely to establish the ethical nature of these practices in themselves, and not to consider their long-range social effects, or even to enter into the abuses which they may occasion. All that will be taken up later.

Buying on margin, despite the esoteric connotation of the term, is basically a very simple, familiar, and accepted method of financing a purchase throughout the commercial world.<sup>1</sup> The purchaser buys some stock, makes a down payment, and then arranges with his broker for a loan with which to pay the seller in full, which must be done within two days, as all transactions on the exchange are for cash. The broker, of course, to protect his loan, requires that there be a considerable "margin" between the current value of the stock and the amount of the loan. The exact size of the margin, before the days of the Securities and Exchange Commission, depended upon the broker's experienced

<sup>1</sup> For a complete discussion and evaluation of margin buying and short selling and their manifold implications, see Meeker, op. cit., Chapter VII, "Credit Transactions in Securities."

judgment as to how likely the price of the stock was to take a sudden fall. If the margin becomes too "narrow", the broker calls his customer for more security, which may be given in the form of money or of marketable stocks and bonds. Essentially, therefore, buying on margin is no different from buying a home on a mortgage. In each case the owner must make over to the loaning agency full title to his equity until the loan is repaid. It is true that the purchaser of a home retains physical possession of the property and that the buyer of stock does not. But this difference does not alter the identical nature of the transaction, because there is no advantage in owning a home except in living in it. On the other hand, the only advantage in owning stock is in receiving dividends from it and in being able to dispose of it at will, both of which rights the purchaser of stocks retains in full as long as his margin remains sufficient. And the identity of margin buying with other commercial transactions accepted as unquestionably ethical is more easily seen in the case of the purchase of commodities or manufactured goods in large quantities where the loan is secured by warehouse receipts. In this latter case, the borrower receives absolutely no benefit from the goods he buys until the loan is repaid.

It is surprising, therefore, to find that even an ordinarily well-informed and sympathetic economist like Msgr. Ryan misunderstanding the stock exchange to the extent of saying:

When the buyer completes one of these trans-

actions, he merely receives or pays out a sum based on the extent to which the price of the goods in question has risen or fallen.<sup>2</sup>

In fairness to the author it must be noted that he is speaking about purely speculative trades, and that as far as the speculator is financially concerned he might as well have done it that way, but the abuse of a thing does not alter its essential position in the ethical scheme. The above quotation, then, as a statement of fact is inaccurate because every buyer must make a considerable deposit with his broker before any purchase is made, and the broker must secure the funds from his own or somebody else's capital for the balance, because he must pay for the stock in full within two days. It is true, he may call upon his customer for more funds if the stock should decline in price, but most speculators are more ready to sell out at a loss than to "throw in" more money on a declining market. Hence, in the ordinary transaction on the Exchange, the buyer, whether he makes money or loses, pays out money every time he buys and receives money back every time he sells.

The odium which surrounds the practice of margin buying is perhaps due primarily to the abuse made of it by unscrupulous brokers and inexperienced investors and speculators, especially during the era of the stock market "craze" in the late twenties.

Added to this is the fact that the broker, although seeming to

<sup>2</sup>-----  
John A. Ryan, "The Moral Aspects of Speculation", The Church and Socialism, University Press, Washington, D.C., quoted by J. F. Leibell, Readings in Ethics, Loyola University Press, Chicago, 1926, 518.

act only as a buying agent, is also a banker in the transaction, and in this double and complex function seems to recall to the ethician the many evasions practiced under cover of the old Contractus Germanicus. But the comparison is not to the point, as the latter was excogitated for the express purpose of circumventing ethical norms, whereas the former is a natural and convenient operation. It would be perfectly agreeable to the broker for his customer to take the stock which he had bought, bring it to his commercial bank, secure a loan on it, and then pay the broker in full for the stock. But there are obviously several inconveniences which are obviated by the standard and universal practice. The broker, because of his specialization in the business, can make something on interest and carrying charges while still charging his customer less than he would have to pay at a bank, and the customer is saved the trouble and expense involved in securing a loan. Buying on margin, then, is nothing more than mortgaging the <sup>E</sup> securities one has bought. It is more dangerous because of the rapid and extreme fluctuations in security prices, and because it can be abused by unscrupulous brokers allowing customers to buy on too thin a margin. But before they advocate extermination, economists should try regulation, which has been instituted by the SEC and whose success will be examined later. Even a clever "bucket shop" operator would not dare to have his customers "receive or pay out a sum based on the extent to which the price of the good has risen or fallen." That would be too obvious, since a bucket shop must

try to present as nearly as possible the appearance of a bona fide broker's office. To require little or no margin would not only decrease this appearance of similarity, but would also bring less money into the owner's pocket.

Much more than buying on margin, short selling has been criticized and condemned -- and rightly so. Margin buying may rightly be considered as a financial practice necessary to enable all but the very richest to obtain an interest of ownership in the productive enterprises of the nation -- an end which practically all economists advocate as a means of preventing the further undue concentration of economic power. But the justification of short selling is neither so easy nor so obvious, and the misuse which has been made of it, particularly in the "Crash" of 1929, was devastating in its results. But here again, the analogy between short selling on the exchange and other commercial transactions which no one ever thinks of questioning is sufficiently close to give great plausibility to a plea for its legitimacy, and on the grain exchange it is a method of eliminating risk which the great flour milling companies claim they could not otherwise bear.

Short selling has been defined as "selling something you don't own". From a certain aspect this is true, and to the layman making a short sale it is just as if he were selling something he did not own. But the philosophy of als ob is hardly a scientific one. From the legal viewpoint the transaction is an entirely different one. A short sale, like any other sale,

is a contract to deliver at a specified time certain goods, for which payment will be received; but in this case the seller does not have the goods which he is going to deliver. In order to analyze fully this type of transaction, it will be necessary to consider the grain exchanges also, since it is in those markets that the short sale is used most extensively and has its widest economic importance.<sup>3</sup> There, too, are found certain differences in the method of settling a short sale which will help materially toward the understanding of its true nature. On the grain exchange the contract always calls for a delivery date several months away (except, of course, in the case of "cash" grain, which offers no difficulty and which is subject to no controversy). The short seller may fulfill his contract by buying actual (cash) grain in time for the specified delivery date, or he may buy another contract before that time and allow the two to cancel out through the mechanism of the exchange. The latter is by far the most common method of closing out the speculative short sale. A short sale, therefore, from the juridical point of view turns out to be nothing more than a contract for a future delivery of grain. The prevalence of such contracts in the commercial world need hardly be indicated. The construction or manufacturing company whose bid is accepted for a government contract is selling short, since it is promis-

-----

<sup>3</sup> For a complete exposition and discussion of "hedging" in grain, consult Raymond T. Bye, Principles of Economics, 3rd Edition, F. S. Crofts and Co., New York, 1935, 181 sq.



ing to deliver certain goods in the future, the raw materials for which it does not yet own. But the classic case is the magazine which accepts perpetual subscriptions: the management undertakes to supply paper made from trees which have not yet even started to grow! This is selling short with a vengeance. Since these contracts are to be considered legitimate, the short sale on the exchange must also be approved unless it can be further proved unnecessary or harmful. The economic function performed by the ordinary contract for future delivery of goods not yet owned is obvious in the case of manufactures, where the product is to be improved through an intermediary process. And it is equally evident in the case of the wholesaler who does not change the goods in a physical way, because he gives them "time and place utilities", which are of equal value in the economic world. But it is claimed that the speculator who trades on the exchange, and never owns so much as a single bushel of wheat, performs no economic service whatsoever, ignoring for the time being the speculator's part in maintaining a fluid market where the advent of a large order from a flour mill will not send prices rocketing, we will examine only his part in making possible the "hedging" operations by which all big handlers of grain insure themselves against undue loss.

The supply of wheat being highly seasonal, it is necessary for elevator and flour mill owners to buy up and store grain far in advance of its actual consumption. This means that in addition to the usual risks of business -- the constant danger of

total loss by explosion and fire, the possibility of loss of customers through competition, business depression, etc. -- there is the additional and immense risk of a drastic decline in grain prices, which means a corresponding drop in the price of flour. To predict and provide for this contingency is beyond the capacities of any economist, save perhaps the most able, since it would require an intimate knowlege of the world market in grain, besides the political acumen required to foresee wars, trade barriers, etc. Therefore, the dealer in grain, just as he insures his plant and equipment against fire, so he insures the value of his commodities in the only way he can -- by hedging. A hedging operation consists in selling short on the grain exchange, the Chicago Board of Trade, for example, a quantity corresponding to the actual grain bought and stored away in an elevator. The "delivery" date of the short sale should also correspond roughly to the consumption date of the grain on hand. Thus, if a miller should buy a hundred thousand bushels of wheat in August to keep his mill going throughout the ensuing twelve months, he would sell short on the Board of Trade, say, fifty thousand bushels of "December" wheat and fifty thousand of "May" wheat. Then, if the price should decline, he will make up on his short sale what he loses on his stock on hand, and if the price should rise, he will gain on his elevator supply what he loses on the short sale. In pricing his flour he must always use the current price for wheat as a base, since there are always some millers buying at current prices for immediate milling.

The importance of this form of protection can readily be gauged from the wide fluctuation in grain prices even in "normal" years, a fluctuation more than sufficient to wipe out all the ordinary profits of regular business. The short sale in grain is, then, a means of passing on the abnormal risks of business to those who can undertake to bear it -- speculators.

But at this point Msgr. Ryan objects that --

... traders in produce should take the risk of fluctuating prices themselves. ...there seems to be no good reason why the capable dealer or manufacturer could not acquire a sufficient amount of ... knowlege and foresight. To set apart a body of men for the sole purpose of dealing in risks seems to be carrying the principle of division of labor unnecessarily far... <sup>4</sup>

However, the miserable failure of the very best financial and economic "services", with their highly trained and experienced economists, to forecast business and price trends with anything approaching accuracy, is sufficient testimony to the impossibility of the average business man's acquiring the necessary "knowlege and foresight". And sufficient foresight would have to be very considerable, since in a highly competitive and over-built industry like milling, the margin of profit is so small that a loss of a few cents a bushel on the total amount handled in one year might well be disastrous, even to the most stable. As for the statement that a separate body of men for the carrying of risks is superfluous, there is the unquestioning acceptance of the indispensable economic function of the large insur-

<sup>4</sup> Op. cit., 520

ance companies. However much they may be accused of overcharging or of accumulating undue financial control over the nation, they are never considered unnecessary as a class for bearing or distributing the more abnormal risks of business, such as fire, theft, etc. It is, of course, conceivable that another method of handling the risk of commodity price fluctuations could be devised, but the fact that no enterpriser has yet ventured into the field should be evidence of its impracticability. The greatest difficulty is that grain price changes equalize themselves (or could be made to do so from the point of view of the insurance man) only over a period of several years, and hence any attempt to handle such insurance would require immense reserves of capital, and would lack that steady income which the business man requires. All other forms of insurance can be made to equalize receipts and payments every year.

Hedging by means of the short sale, therefore, must be considered a necessity of modern commercial procedure.<sup>5</sup> It is not perfect, and almost of necessity gives rise to numerous abuses, which, however, may be mitigated by proper regulation. The necessity and effectiveness of governmental regulation will be considered later; the point to be noted here is that in itself short selling on the Board of Trade is a necessary and perfectly

<sup>5</sup> Here the objection might validly be raised that it is this very short selling and consequent speculation which causes the price fluctuations against which hedging is necessary. There is much to be said for this point of view, and it will be considered at length in the fourth chapter.

legitimate practice.

But short selling on the stock exchange is a slightly different matter because of a certain complication in the matter of handling it. The short sale in grain is always "covered" by a purchase of some sort, and of course, the person who sells stock short expects eventually to buy back what he has sold, but actual delivery of the stock sold is made to the buyer, not by purchasing stock to give him, but by borrowing it. The reason for this discrepancy in practice between the two types of exchange is that speculation in commodities is always in "futures", i.e., in contracts for delivery at a date some months in the future, whereas corporate securities are traded for immediate delivery, i.e., within a few days. Hence it can readily be seen that there would be no use in selling short if one had to buy back almost immediately in order to make delivery to the purchaser. Instead, the short seller or his broker goes to the loan market and "borrows" the necessary amount of stock, after having put up an equal value of collateral. Ordinarily, the loaner of the stock charges no further premium than the use of the money during the period of the loan. Then, when the short seller wishes to "cover", he buys back his stock in the open market, and with this purchase returns the number of shares borrowed. Fortunately for the speculator, one share of a particular class of stock in a given company is as good as any other, so he is not at all bound to return the identical certificates borrowed.

In the ethician's effort to determine the legitimacy of this transaction, he does not find that clear economic necessity that obtains in the case of the short sale in grain. For the sole benefit to the economic system which the short seller in stocks is said to confer is the more dubious one of maintaining a steady market and of equalizing prices. As this claim will be weighed and judged in a later chapter, the discussion, for the present, will be limited to the intrinsic aspect of the trade.

Although the parallel which was drawn between the short sale of grain and other very common and accepted commercial transactions can also be used here in a limited manner, since merchants frequently have to borrow to complete contracts, yet the argument does not have the same force because of the purely speculative intention of the seller. He is not required to sell short by any exigency of his business, and doubtless does not venture upon such a dangerous course of action solely, or even primarily, from a sense of his public duty to check the advance of an over-accelerated market. And there is no doubt that the short sale has been used for selfish and criminal ends ever since its appearance on the exchange. The extent of the abuse of short selling cannot be estimated, even approximately, since all the evidence of its use is locked in private archives. But there can be little doubt that the precipitancy of the decline of the stock market in the autumn of 1929 and its accompanying confusion and ruin were due to the large-scale and premeditated action of operators who cared much for their financial aggrand-

izement and little for the public weal. Granted that deflation was needed, and needed badly, yet it should have been brought about in some other way less drastic and less likely to undermine the morale of the people and their leaders.

However, on the other hand, it is very difficult to condemn short selling on its own intrinsic nature. Therefore, for the present, we will have to confine ourselves to saying that on the stock exchange it is a practice of doubtful utility and of very dangerous possibilities, which perhaps should be abolished entirely, or at least closely regulated if it can be shown to have a certain general benefit in the just determine of security prices. These matters will be more fully investigated later.

## CHAPTER III

### REGULATION OF THE STOCK MARKET

During the course of its long existence, the stock exchange has been continually decried as an unhealthy center of gambling and wild speculation in the welfare and integrity of the nation. Most of the opposition has been undertaken in a crusading spirit and has based its demands for the suppression or drastic regulation of the exchange more upon emotion than upon sober reasoning. Two notable exceptions to this statement are the investigations of the Hughes Commission<sup>1</sup> of 1909 and the Pujo Committee<sup>2</sup> of 1912. The latter committee, while admitting the necessity and usefulness of a national stock exchange, brought forth as its principal criticism the large turnover of stocks listed on the New York Stock Exchange.<sup>3</sup> For example, there changed hands during the course of the year 1911, over thirty-one million shares of General Motors stock, even though the entire number of shares outstanding at that time was barely over five million. And since, no doubt, a large proportion of those

1 "The Governor's Committee on Speculation in Securities and Commodities", appointed by Governor Hughes of New York State to investigate local conditions.

2 Otherwise known as the "Money Trust Investigation", whose report was made to the United States Senate Committee on Banking and Currency.

3 Wall Street Journal, Dec. 7, 1912, quoted in Van Antwerp, William C., The Stock Exchange from Within, Doubleday, Page and Co., Garden City, 1914, 177.



shares never changed hands at all, the ratio of turnover on the rest was still higher. Certainly, this fact would strike one immediately as indicating a far too large speculative element in that stock unless good reason could be given for it. A commentator in the Wall Street Journal gives his justification, which is presumably the one current in the "Street".

The ratio of six to one suggests healthy activity in the market... It is conceivable that a block of stocks may pass through many hands before it arrives at its ultimate owner, just as a crop of potatoes passes through a long chain of handlers and buyers and dealers before it reaches the ultimate consumer. Meantime the number of potatoes has neither increased nor diminished. But the potato crop, which easily changes hands six times a year, is finally eaten. The stocks go on forever. The legitimate holder is not injured if they change hands not six, but sixty times, provided he is secured by proper publicity, which the Stock Exchange assures.<sup>4</sup>

This quotation is given at length to show the type of reasoning which even an "enlightened" and semi-official apology may make use of. There is no doubt that a ratio of six to one shows activity, but whether this activity is healthy or not is the whole point at issue, and the parallel with potatoes is not entirely to the point. First of all, the present system of distributing potatoes is not to be held up as an ideal in the economic system, and in fact economists have not ceased to decry the enormous wastes in distributing produce in general. Secondly, it may conceivably be necessary that potatoes pass through so many hands in order to be handled efficiently. Here the ques-

-----  
<sup>4</sup> Ibid.

tion is -- must stocks be traded that often before they reach the hands of permanent investors? It is true that the stockholder who has his certificates safely put away in his deposit box is not injured directly by speculation on the exchange, but the social cost of maintaining an institution of the size of the New York Stock Exchange solely or primarily for selfish speculation must also be considered. The objection of the Pujo Committee was left unanswered, but its soundness is amply demonstrated by the fact that later condemnation of the exchange has generally been on the charge of over-expansion.

The commission appointed by Governor Hughes three years before the more comprehensive and general Pujo investigation, made a thorough study of the New York Stock Exchange, and produced a lengthy, but very moderate, report. Here again, the chief objection was the over-expansion of speculation.

The problem, wherever speculation is strongly rooted, is to eliminate that which is wasteful and morally destructive, while retaining and allowing free play to that which is beneficial. The difficulty in the solution of the problem lies in the virtual impossibility of distinguishing what is practically gambling from legitimate speculation. The most fruitful policy will be found in measures which will lessen speculation by persons not qualified to engage in it. In carrying out such a policy, exchanges can accomplish more than legislatures.<sup>5</sup>

The Committee further blames the Exchange for not having realized its obligations sooner, but places confidence in it by opposing the public demand for incorporation in order to give

<sup>5</sup> Report of the Governor's Committee, quoted in Van Antwerp, op. cit., 415 sq.

the governing committee of the Exchange full jurisdiction over its members. Such control would, of course, be lacking in a corporation, whose members could make use of an injunction against the Exchange.

In common with most American business men, the members of the stock exchanges of the country have been very slow to recognize the extent of their moral obligations toward society as a whole, and theirs perhaps is a greater guilt in proportion as their responsibility is greater than the average. But it must not be supposed that the Exchange had done nothing before 1909. As early as 1869 the New York Stock Exchange had required all corporations whose stocks were listed to register their issues with independent banks or trust companies in order to obviate any possibility of fraudulent over-issue. About the same time full and instantaneous publicity was inaugurated for all transactions by the installation of the ticker system; and all stocks granted the privilege of full "listing", in contradistinction to the smaller "unlisted" department, had to be thoroughly investigated by a special Committee on Stock List before being approved. However, the Hughes Commission went further in advocating that the Exchange require more complete, extensive, and frequent financial and operating reports from the corporations concerned. Although the response to this advice may not have been as prompt as the Commission might have desired, it was steady and progressive enough to lead Professor W. Z. Ripley to assert in 1926 --

Beyond peradventure of doubt the N. Y. Stock Exchange is today the leading influence in the promotion of adequate corporate disclosure the world over. Its evident disposition to accept fully the responsibilities of its status ... merits high praise.<sup>6</sup>

The Hughes Commission made several other minor recommendations, but, as mentioned previously, advocated no radical legislation, and left things pretty much up to the Exchange members themselves. One of the reasons for this attitude seems to have been a lack of familiarity with Exchange operations on the part of the members of the Commission, or perhaps a certain lack of ingenuity which would enable them to proscribe undesirable practices without thereby prohibiting the desirable ones. Certain it is that the rules of the present Securities and Exchange Commission evince a complete grasp of the mechanism of stock market technique and a great cleverness in directing it along its due course.

The next great investigation of the Exchange was undertaken at the instance of President Roosevelt in 1933. Whatever praise might have been dealt out to the Exchange before 1929, even by such a disinterested economist as Professor Ripley, everyone admitted that the debacle of that year proved that another attempt should be made at reform. Perhaps the blame should not be put upon every one of the members and operators of the Exchange, but it seemed that many of them had acted violently anti-socially. In launching his comprehensive investigation of

<sup>6</sup> Main Street and Wall Street, Little, Brown and Co., Boston, 1927, 210.

the securities business in all its aspects, the President enunciated a new principle of business.

This proposal adds to the ancient rule of caveat emptor, the further doctrine "let the seller also beware". It puts the burden of telling the whole truth upon the seller. It should give impetus to honest dealing in securities and thereby bring back public confidence.<sup>7</sup>

This statement refers to the Securities Act of 1933, but it also meant a new era in the stock market. The Securities Exchange Act of 1934, based upon a most thorough investigation, created the Securities and Exchange Commission to administer both Acts, closely related as they are. This action was a complete reversal of the attitude of the Hughes Commission. No longer was complete reliance placed upon the public spirit of the Exchange and its ability to correct abuses, and no longer was the government considered inadequate to deal with the problem.

The Securities and Exchange Commission (SEC) was given almost complete control over the stock markets of the country, and at once proceeded to put in force the provisions of the Act, and to use the discretionary powers accorded to it. It is the purpose of this chapter, then, to consider how it has handled each of the major problems with which it was confronted. The first specific problem to arise was that of trading on margin. As was demonstrated in the preceding chapter, it is very difficult to condemn this practice absolutely, since it seems just as

<sup>7</sup> Federal Securities Act, "Hearings before the Committee on Interstate and Foreign Commerce of the House of Representatives", U. S. Government Printing Office, Washington, D.C., 1933, 1.

much a natural and constitutional right to buy securities by means of a loan as to purchase a home in the same way. Moreover, the customer is more likely to get favorable terms from his broker than from his banker. The chief danger of margin buying is that of trading on too thin an equity, and it was from this angle that the SEC attacked it. In the Act itself the following limitations were made:

For the initial extension of credit, an amount not greater than whichever is the higher of --

- (1) 55 per centum of the current market price of the security, or
- (2) 100 per centum of the lowest market price of the security during the preceding thirty-six calendar months, but not more than 75 per centum of the current market price. <sup>8</sup>

In other words, the investor or speculator must "put up" at least 25 per cent of the current market price, and is sometimes required to pay up to 45 or even 75 per cent -- a rather cautious and conservative regulation in view of the Hughes Commission recommendation that the Exchange use its influence to prevent members from "generally accepting business on a less margin than 20 per cent." The clause referring to the lowest price within the past three years is added to differentiate between the more speculative, and therefore volatile, shares and the more conservative investments. A stock, for example, which has never gone below 70 per cent of its present value may be purchased upon a margin of only 30 per cent, whereas one which has declined to, say, a third of the current quotation within the

8 Securities Exchange Act of 1934, 7.

preceeding three years requires a margin of 45 per cent. The wisdom of this regulation is perfectly obvious, and in fact similar policies had long been followed by the more conservative houses, and had even been enforced to a limited extent by the Exchange itself. The Exchange possesses sufficient sanction with regard to its members in the power to suspend their expensive memberships temporarily or permanently, and has often had recourse to such a drastic measure. Yet the SEC ruling affords additional motivation by rendering the culprits liable to prosecution by the Federal courts. Moreover, the SEC is further empowered to revise these requirements "up or down" as circumstances and the condition of the money and security markets may require. The advantages of this latter provision are very important. Had the Commission existed in 1929, stock prices might not have reached nearly so high a level, and the consequent fall might not have been so sudden and disastrous. For when security prices had begun to exceed all reason and to "discount" the future for ten prosperous years, margin requirements could have been raised to prevent further commitments and to keep prices on a fairly safe level.

One of the reasons for the magnitude of the crash of 1929 was that very many brokerage accounts were carried on such a slender margin that as soon as the market declined appreciably, the brokers were forced to call for more margin. Since this could not readily be supplied, they had to throw their clients' holdings upon the market to be sold at any price that could be

gotten. A strictly-enforced rule of adequate margins would have obviated the worst aspects of the debacle by preventing the initial over-expansion of the market through a reduction in the effective purchasing power of the speculator's original deposit. In addition, the small investor could have been dissuaded from trading at all, since many such never become confirmed "addicts" until they are able to buy and sell in "round lots" (multiples of 100 shares), which they could do only if margin requirements were low. Then, when the break in the market did come, speculative accounts would have been more ready to withstand the sudden assault of the "bears", and would have had sufficient time to be bolstered up. Finally, after the decline, the Commission could have lowered margin requirements with safety, and thus encouraged the entrance of further buying power into the market. Such flexibility, akin to the operation of the rediscount rate in the money market, was entirely lacking in 1929, when it was most needed. Of course, the intelligent use of this power of control would have required trained and sagacious economists, but, as is evidenced by the raising of the rediscount rate early in 1929, they were not entirely lacking in that frenzied era of expansion. That action was taken mainly with a view to curbing the stock market, but since the effect was only indirect, except perhaps psychologically, the results were scarcely noticeable. Besides, what handicap was it to have to pay one or two per cent more for the money borrowed, if the principle could be doubled within a few months? Such was the



view of the optimistic speculator.

The effect, then, of this provision on margin regulation is to reduce speculation as a whole, and to protect by elimination the small speculator, who needs protection most, since presumably he is less able to bear his occasional, or inevitable (as some would have it), losses. It goes further in eliminating some of the undesirable speculation by preventing the more daring large operators from bringing additional instability into the market by their own precarious margins. But comparatively little was done to distinguish and quash that speculation which is "practically gambling" -- which was the principal objective of the recommendations of the Hughes Commission. The next chapter will inquire into that speculation which, for lack of very obvious good or evil effects, may be called useless or parasitic. For the present, evil speculation may mean that which produces definitely injurious effects.

In its regulation of short selling the SEC has shown a remarkable insight into the technical operations of the Exchange, as well as a good deal of clever ingenuity in regulating them according to ethical norms. As was pointed out in the previous chapter, the chief objection that can be raised against short selling is not so much the illegitimacy of the practice itself, but rather the harmful use to which it has been put. When a small investor, deciding that a certain stock is selling far above its worth, sells it short, he exerts a beneficial effect upon the market (if his judgment is correct) inasmuch as his

sale tends to keep the price from rising further. Moreover, if he is fortunate and the stock declines fairly rapidly, his buying back of the shares sold short has a bolstering effect on the stock. In the same manner and in proportion, the large operator trading in the same way has an equalizing and steadying effect upon the market. But the short sale, especially in the hands of one or more men with ample resources at hand, can be used with disastrous effect to "break" the market. When a powerful "bear" or group of bears perceives that the market is "thin" in a particular stock (i.e., there are few buying orders immediately below the current price), he or they may attempt to break the price, and by means of the short sale to reap a considerable gain at the expense of others.

First of all, the bear sells any of the stock which he may happen to own, and perhaps also a good number of shares short. Since the market for that stock is already thin, it begins to decline, but the bear still gets a fairly good price for his sales. Then, when he deems the moment opportune, he plunges in and starts to hammer down prices by offering to sell to any buyer at any price -- the lower the better. Immediately the price slumps badly in increasing trading, every broker in the country begins examining the accounts of all his customers who hold that security, and many calls for more margin are sent out. All this may take place within a half-hour, and if the decline is rapid enough, numerous speculators will be notified by telephone to place additional security immediately to strengthen their

account with their brokers. Inevitably there will be some unable to comply with these margin calls, and their entire accounts will have to be sold out at the price obtainable at the moment, thus further depressing the market. The effect of the initial decline, therefore, is cumulative, and may easily turn into a panic. Meanwhile, the bear, once the decline is well under way and moving of its own momentum, ceases selling and tries to determine the point at which the bottom will be reached. There he buys back, as covertly as he can, all the shares he has sold short, and perhaps he may even "go long" again, realizing a handsome profit on the whole transaction.

Of course, it must not be assumed that such bear operations are easy or infallible means of making money. On the contrary, they are very dangerous, and require great shrewdness and daring as well as much good luck. In the first place, it is difficult to find out when the market is thin. Then, at any point in the decline new buying orders may come rushing in, and may even turn the course of prices in the opposite direction, leaving the bear operator with a heavy loss. But bear raids on the stock market have been of frequent occurrence throughout its history, and they are particularly fatal when the raid is upon the whole list of stocks simultaneously and by a determined and wealthy group of men pooling their resources. To distinguish a minor bear raid from a fortuitous conjunction of orders of the same kind is ordinarily very difficult, and has led common financial news parlance to ascribe every rise or fall in prices to bull or bear

action.<sup>9</sup> At times there can be no doubt about it. The most famous and disastrous bear raids took place during October and November of 1929, when with the average day's trading around four million shares, sixteen million were traded on a single day. The catastrophic results of this sudden fall of prices needs no development here. Drastic liquidation doubtless was needed, but coming as it did, it ruined many by the annihilation of their purchasing power, and destroyed the general confidence not only in the stock exchange but also in the very foundations of our national economic life.

To the task of preventing any repetition of such a debacle the SEC set itself. As already indicated, the problem is not how to eliminate all short selling, since some of it is undoubtedly beneficial, but how to prevent the breaking of the market through short sales. This was solved by prohibiting the short sale of any security --

- (1) below the price at which the last sale thereof, regular way, was effected ... or
- (2) at such price unless such price is above the next preceding different price at which a sale of such security, regular way, was effected ...<sup>10</sup>

(Regular way means "long" stock, i.e., stock actually owned.)

Furthermore, all orders in the future were to be marked either "long" or "short", and no broker could execute an order not so marked. The effect of this regulation was to make very diffi-

<sup>9</sup> It is now an established, if unfortunate, facon de parler.

<sup>10</sup> Securities and Exchange Commission, General Rules and Regulations under the Securities and Exchange Act, 1941, 1001.

cult any kind of short selling during a declining market, and to practically prohibit the breaking of the market except with "long" stock. The ingenious effectiveness of these two rules, especially the second, has been quite remarkable. If only the first were in force, a bearish operator could begin to break prices with a hundred shares of long stock, and then follow through with as much short stock as would be bid for, using his long stock only on each initial lowering of the price. But when the short sale must be above the preceding higher price (in a declining market), his usual technique is impossible.

Of course, where enough resources can be pooled to start a decline which will continue of its own momentum, breaking the market with long stock will still be profitable, but this is an extremely dangerous practice, and one which repays little for the huge risk involved. Moreover, the SEC has other ways of dealing with such large-scale piracy. As soon as any unusual activity has occurred in any stock, all the brokers involved are immediately requested to furnish the names of buyers and sellers to the Commission, which can then proceed against the offenders on the charge of manipulation of prices. Up until 1933 the common practice of every pool was to have its orders executed by numerous different brokers, who might not themselves have understood the part they played in the whole. Now this subterfuge is unavailing.

Thus, two clever but simple rules have in great measure achieved what the Hughes Commission ardently desired but was

unable to accomplish -- the distinguishing of beneficial speculation from that which (in intention at least) is practically gambling, and the protection of the one and the elimination of the other.

The SEC likewise made rulings to cover all other undesirable practices upon the exchange, but these had already been pretty well covered by existing state laws as well as by the regulations of the various exchanges themselves. "Wash sales" (i.e., a fictitious sale by a broker to himself for the purpose of publicizing an artificial price), for example, are very easy to detect and eliminate. "Matched orders" (i.e., two orders given to different brokers by one and the same person for the same purpose as a wash sale) are more difficult to detect, particularly in an inactive market; but the incentives for using such methods are largely removed by closer regulation of the original security issues, in connection with which it is desirable to maintain an artificially high price on the exchange for the purpose of establishing an "over-the-counter" (non-exchange) sale price for unsuspecting investors. For the latter are always quite willing to buy stock directly from a dealer at a price which they see publicized in stock exchange quotations, thereby saving the broker's commission.

Probably the greatest general reform made by the SEC is the publication of financial and operating reports required of every corporation whose stock is widely distributed among the public. Elaborate regulations were made to bring to light everything

which might be of value to the investor. The SEC itself does not undertake to publicize all the information it receives, but it does respond to every request; and hence current data are to be had by every interested investor at any good library, bank, or brokerage house through the instrumentality of such financial services as Moody's, Poor's, and Standard Statistics. Today at last, the "imp<sup>11</sup>ublicity" which Professor Ripley decried so vehemently and justly is a thing of the past for any investor who will go to the slight trouble of examining the published records.

Although the stock exchange had already shown the way, and still furnishes valuable cooperation, most of this publicity is required through the provisions of the Securities Act rather than the Securities Exchange Act. Because of this fact, and also because of the myriad complexity of the rules, no further analysis of this aspect of the question will be made here. Indeed, such an examination could well turn into a lengthy treatise on the ethics of accountants' reports in relation to the investing public.

-----  
<sup>11</sup> Op. cit., Chapter VII, "Imp<sup>11</sup>ublicity: What To Do about It."

## CHAPTER IV

### SOME LARGER ASPECTS OF REGULATION

Even though it be reasonably clear that the stock exchange is a necessary institution and that its more flagrant abuses have been cleared up, there still remains the fact that it seems to have subordinated its primary function to the wholly secondary one of speculation. The primary purpose of the exchange is to provide a market for corporation securities so that prices to investors may be arrived at in a free and open manner, and with full information as to market conditions available to all participants. In forwarding these ends the New York Stock Exchange has been untiringly aggressive.<sup>1</sup> Nor is it to be denied that speculation must play a large part in such a central market.

Alfred Marshall, for example, asserts that --

It has been well observed that a speculator, who without manipulating prices by false intelligence or otherwise, anticipates the future correctly, and who makes gains by shrewd purchases and sales on the Stock Exchange ... generally renders a public service by pushing forward production where it is wanted and repressing it where it is not.<sup>2</sup>

Here, however, it must be noted that speculation on the exchange does not directly react upon production by immediately supplying the corporations concerned with new capital to extend their

<sup>1</sup> Cf. H. S. Martin, The New York Stock Exchange, New York, 1919, Chapter 22, "The Exchange as a Moral Force."

<sup>2</sup> Principles of Economics, Macmillan and Co., London, 1930, 8th Edition, 432, n.



plants and facilities, for such trading is merely in stock that has already been issued and fully paid for. Any gain from a rise in price is received by the individual holder of the stock, and not by the issuing company. But a rising market for any particular company's stock would enable it to issue new securities, whether bonds or stocks, more readily and easily, in larger amounts, and on better terms for its own financial interest than it would if the publicity of the exchange were lacking. And, as Professor Bye says,

A useful adjunct to both investment and commercial banking is the stock exchanges .... Investors would be reluctant to put their money into stocks or bonds if there were no machinery for selling them later if desired. Moreover, by finding a market for older issues, underwriters can sometimes get their customers to buy new issues which the former are trying to dispose of. <sup>3</sup>

Thus the exchange supplies the publicity and ready market which even the "permanent" investor looks for in buying any security. As an illustration of the common estimation of the desirability of this listing of a security, the "spread" in price between a listed and an unlisted bond of the same company and the same security is sometimes a couple of points.

Then too, it must be remembered that speculation makes for a larger and more active market, and that --

The larger the market for a commodity the smaller generally are the fluctuations in its price, and the lower is the percentage on the turnover which dealers charge for doing business in it. <sup>4</sup>

-----  
<sup>3</sup> Op. cit., 211.

<sup>4</sup> Alfred Marshall, op. cit., 328.

Although the first part of the statement is open to challenge, since speculation is commonly blamed for the violent fluctuations of stock prices, yet the second part is abundantly true. The purchase, for example, of a hundred shares of stock selling anywhere between a hundred and two hundred dollars a share would cost only twenty-five dollars -- on a contract amounting to anything less than twenty thousand dollars! This commission amounts to no more than a quarter of one per cent; a like rate in the real estate business would put all the realtors out of business in short order. Of course, they perform functions which the stock broker does not, but that is the advantage of the central market.

Another aid which speculation gives the investor, especially the small one, is in the purchase and sale of "odd lots" (i.e., fewer than a hundred shares). Up until the middle of the twenties, most odd lots used to be handled on the Consolidated Stock Exchange, since defunct, but after that time all such orders have been taken care of by an elaborate machinery on the exchange itself, without, however, the investor's losing the benefits of small commissions. There are two large houses in New York City which deal exclusively in odd lots, and to whom all other brokers turn over their orders. These orders are not actually executed on the floor of the Exchange, but are grouped, cancelled out whenever possible, and "traded against" on the Exchange. The customer submitting the order is guaranteed a price of an eighth (or sometimes a quarter) of a point away from

the next round lot sale which takes place after his order has been received. This means that if he is buying stock he pays an eighth of a point more than the next sale printed on the ticker tape, or if he is selling he receives an eighth of a point less. The reason for trading exclusively in round lots on the "floor" is quite apparent from the daily volume of business, but the rule does leave a huge problem to be solved. The odd lot houses were formed to take up the challenge, and have handled it very satisfactorily. Since they guarantee prices based upon the next sale, they are continuously both "long" and "short" stock, which they must sell or buy in as best they can. Obviously, such a business can be conducted only on a large scale, and that is why there are only two houses handling all the odd lot business. If these houses were not allowed to sell short and to speculate in buying stock, the small investor would have to lose two or three points, instead of an eighth, in buying or selling his odd lot.

Here again, a speculative market is a means of placing the small man more nearly on a par with the wealthy capitalist. In fact, in a rising market the small buyer has a distinct advantage: he is practically guaranteed the next sale, whereas a large order would have to wait its turn and pay a higher price.

But in spite of these very obvious services of speculation in the cause of permanent and sound investment, it is maintained that speculation on the stock exchanges of the country, and of the world, has expanded beyond all reason, and has come so to

dominate these markets that they seem to have lost their primary function of centers of investment and to have turned into glorified gambling dens.<sup>5</sup> There can be little doubt that this charge has a firm foundation in fact, although the extent to which speculation dominates the exchange cannot be ascertained with any degree of accuracy. However, the eminent authority of John Moody lends weight to the opposite opinion in the statement that "a greater sum of money is annually lost in this country through unwise investment in Wall Street, than through pure speculation."<sup>6</sup>

At this point it would be well to try to distinguish the various types of speculative dealings to be found in general use. First of all, the speculator must be distinguished from the investor. The latter buys a stock for a relatively long term, and more with a view to the income to be derived from it than for any anticipation of selling it at an increase in price. The speculator, on the other hand, buys stock for the "short turn" solely with a view to selling it at a higher price. But this "short turn" may vary from a few minutes to several years, depending upon whether the buyer is a long-term speculator or a "specialist" who happens to be "making a market" in the particu-

<sup>5</sup> Another serious charge against stock market speculation is that it ties up huge amounts of capital in the form of brokers' loans, thereby withdrawing it from production. This question is thoroughly discussed in Horace White's Money and Banking, Ginn and Co., Boston, 1925, New Edition by C. S. Tippets and L. A. Froman, 612 sq. Since prominent authorities are cited for contradictory views, and since the authors espouse neither side, the matter will not be considered in this thesis.

<sup>6</sup> The Art of Wall Street Investing, Moody Corp., New York, 1906, 111.

lar stock he is handling. In putting an ethical evaluation upon speculative transactions, then, there occurs the difficulty which long ago confronted the Hughes Commission -- the separation of that which is good from what is practically gambling. The long-term speculator may generally be admitted to perform a useful economic service in directing the flow of capital, as was previously indicated. It may be argued, too, that the two-minute speculator may perform an equally useful service. If, for example, an order comes to the floor of the New York Stock Exchange to sell a thousand shares of U. S. Steel "at the market" (i.e., at the best price obtainable at the moment) at a time when there are few buying orders at hand, the seller would stand little chance of getting a good price unless there were speculators at the post. Large blocks of stocks held by investors must frequently be sold on short notice when neither the owner nor his broker would be capable of direct supervision in securing a good price. However, in every active stock there are always a few speculators, floor-brokers and specialists, who know the ordinary demand and supply of that particular stock. So, when a large selling order comes in a weak market, they bid against each other to get it, knowing that in all probability they will be able to dispose of it at a small profit within a few hours. The profit taken may be only an eighth or a quarter of a point, but if the operation is repeated often enough, as it is, a good living can be made from this practice.

Such speculation, though in no wise long-term, should be

classified as beneficial, since it is essential to the maintenance of a steady market. Likewise, the similar "in and out" technique of the odd lot dealer reacts decidedly to the advantage of the bona fide investor. And it often happens that stock bought for long-term investment is sold within a short time because the owner thinks that it has risen above what it is worth, and thereupon decides to take a speculator's profit, or because he realizes he made a poor choice.

The thing which ultimately puts speculation in the category of good or bad is the intention of the speculator, but since regulation could scarcely be undertaken on that basis, other norms will have to be applied. The simplest and most obvious course to pursue in the elimination of evil speculation, the kind which rests upon vague rumors, "tips", and manipulation, would be to close down the stock exchanges immediately and completely. While such a course has been openly advocated by very few, it would seem to be implied in the condemnations generally meted out to the exchange. Msgr. Ryan, for example, in a résumé of his analysis says --

Speculation as an institution is of doubtful utility; socially it is productive of great and widespread evils; and morally it is vitiating by a very considerable amount of dishonest "deals" and practices.<sup>7</sup>

Likewise, Fr. Slater cites with approval the suppression of speculation on the Berlin Stock Exchange.<sup>8</sup>

-----  
<sup>7</sup> Op. cit., 528.

<sup>8</sup> Rev. T. Slater, S.J., "Speculation", The Catholic Encyclopedia, XIV, 211.

But the Berlin Stock Exchange is a case in point which shows the futility and positive harm which follows strict and repressive measures. In justice to the German economists of the time, it must be said that a commission of investigation had turned in a moderate report, similar in tone to that of the Hughes Commission in this country, but the agrarian Reichstag took matters into its own hands and formulated the Bourse Law of 1896. The effect of the prohibition of ordinary speculation on the Exchange was to drive it into "underground" channels, where it flourished in a more evil manner than ever. Professor Emery enumerates a number of disastrous effects, among which were the following --

(1) Fluctuations in prices have been increased rather than decreased. The corrective influence of the bear side of the market having been restricted, the tendency to an inflated bull movement was increased in times of prosperity.

(2) The money market has been increasingly demoralized through the greater fluctuations in demand for funds to carry speculative cash accounts.

(3) Finally, the effect of interference, increased cost, and legal uncertainty was to drive business to foreign exchanges. The number of agencies of foreign houses increased four or five fold, and much German capital flowed into other centers, especially London, for investment or speculation. 9

Ten years after the enactment of the original legislation a Government commission was forced to admit that --

The dangers of speculation have been increased,

-----  
 9 Henry Crosby Emery, "Ten Years' Regulation of the Stock Exchange in Germany", The Yale Review, May, 1908.

the power of the market to resist one-sided movements has been weakened, and the possibilities of using inside information have been enlarged. 10

Acting upon the recommendations of this report, the Reichstag repealed most of the provisions relating to trade in stocks, but still retained the prohibition against short selling in grain and flour until the continued disastrous results proved beyond question its futility.

As there are no open markets for these products and no continuous quotations, both buyers and sellers are at a disadvantage; prices are more fluctuating than they were before the passage of the law against short selling. 11

The only experience of this country in a similar matter occurred during the Civil War.

When the greenbacks became the regular money of the country, there was established in the city of New York a "gold exchange", a speculative market where people met daily to buy and sell gold... As the greenbacks depreciated, there were great complaints about the high price of gold, and many people charged that the speculation on the gold exchange was responsible... Congress gave ear to the complaints and passed a law abolishing the gold exchange and forbidding all speculative dealings in gold. The result was immediate and disastrous. Nobody knew where he could get gold or sell gold or what the price was... Instead there was bargaining and higgling at various places, and widely differing prices were quoted in different places. The price, instead of falling as hoped, immediately rose higher than ever... The demand for the restoration of the exchange was so prompt and so strong that Congress repealed the law just two weeks after its passage. 12

-----  
10 Ibid., 240

11 Hughes Commission Report, quoted in VanAntwerp, op. cit., 446.

12 Fairchild, Furniss, and Buck, op. cit., 90.



The first point to be noted about these two unsuccessful experiments is that the free and open market of the organized exchange was replaced by an under-cover and disorganized one where fraud was easy to perpetrate and hard to discover and rectify. Secondly, price fluctuations in wheat in Germany became more violent, and the price of gold in this country went still higher. And it was the exact opposite of these effects that the respective laws were intended to accomplish.

With regard to the first point, the fundamental fact which the legislators overlooked is that wherever large numbers of people are interested in buying and selling a homogeneous commodity, there will not only be created markets for that commodity, but they will all tend to gravitate to one central place, where, because of the large volume of business, the market will become highly organized and complex, and its operations open and public. And that is exactly the case with the stock market. In spite of its external similarity to a gambling casino, it is a natural and inevitable result of fundamental economic tendencies where free men are allowed to use their money as their own. Throughout this discussion it is very important to keep in mind that the argument is not that stock exchange operations are ethical because they are inevitable, but rather that, being in themselves indifferent, they serve the public interest when conducted as they are. To close down or cripple the present work of the stock exchanges would be to open the door to private vice and public disaster.

As to the effect upon prices of organized and unorganized markets, the two cases cited do not prove anything conclusively. The rise in gold prices subsequent to the closing of the exchange was due principally to other factors, such as fear inspired by the drastic move, and by the increasingly grave financial situation of the government. But the violent fluctuation of grain prices after the restrictions in Germany would seem to indicate some stabilizing influence on the part of free speculation on an organized market. In this case, the complete and full dissemination of news and the openness of trading afforded by an exchange had not been lost; what was lacking was the discounting of the future by "futures" trading and the restoring effect of short selling. Continuous trading in futures have the advantage of keeping before the eyes of the large grain consumers the necessity of spreading a definitely limited supply of grain over a whole year's consumption, and thus tending to even out fluctuations from month to month.

So much has been said about the practice of breaking the market by short selling that its more ordinary use is apt to be overlooked. Since so to break the market is dangerous and requires large stores of capital, the common use of short selling is merely to profit by selling at the top and buying back at the bottom. When a market declines rapidly, there is always a considerable "short interest" which is looking for a chance "to take a profit" by buying back, and this short interest is the only thing which makes possible any market at all on days of

real panic, such as the worst days of 1929. During these times, when everyone was trying to dispose of stock as fast as he could do so, there was not a single issue for which as many buyers could not be found as there were sellers. Of course, the sellers had to take greatly reduced prices, but that was better than being forced to hold, as many real estate investors were obliged to do, for lack of buyers at any price. How much of this "support" in the market was due to the short interest, is still a secret, and will probably always remain so, but it is believed to have been the major part.

From all this might be drawn the following conclusion -- that the abolition of the exchange is impossible and undesirable, and that any regulation or legal restriction which drives business off the regular exchange defeats its own purpose. But it is equally clear that the exchange must be subject to constant and close surveillance and regulation to curb the inevitable tendency to over-speculation. This regulation should take on a twofold form -- blanket rules designed to discourage too-expansive tendencies, and certain discretionary powers suitable for coping with evasive practices. In this country the former have been supplied by the Securities Act and the Securities Exchange Act, and wide discretionary powers are in the hands of the SEC. An idea of the extent to which speculation has been curbed by these acts may be gained from the following table. It may be objected that other forces were at work also, and no doubt this is true. But there were forces working in both directions, and

there seems to be no good reason for ascribing the cause to anything else than governmental regulation.

TOTAL SALES ON THE N. Y. STOCK EXCHANGE <sup>13</sup>

(in millions of shares)

1925 - 452	1934 - 324
1926 - 449	1935 - 382
1927 - 577	1936 - 496
1928 - 921	1937 - 410
1929 - 1125	1938 - 298
1930 - 810	1939 - 258
1931 - 577	1940 - 208
1932 - 425	1941 - 167
1933 - 655	1942 - 124

From this table it will be seen that when regulation began in 1934, total yearly sales were cut more than half, and that the "boom" year of 1936 scarcely brought trading up to the level of what brokers called the exceedingly dull years of 1931 and 1932. Added to this is the much lower level of stock prices, which makes the total dollar volume of speculation much smaller. And, whatever, may be the cause, the American public has entirely lost its stock market "craze", and is no longer dominated by that "get rich quick with no work" mentality, which was the greatest evil, public or private, which the stock exchange ever had a hand in.

However, it may possibly be argued whether or not even this large reduction has brought speculation within reasonable bounds, and if at some time in the future a state of prosperity and unwarranted optimism should again prevail, what guarantee is there

<sup>13</sup> World Almanac, 1942, New York World Telegram, 427.

that the present system of regulation will be able to cope with it? In that case full reliance must be placed on the wisdom and integrity of the members of the SEC. On a rising market they can impose the restriction of higher margin and moderate use of the short sale, and to a declining market they can give the support of a reverse procedure. Moreover, manipulation on a large scale can be prevented by prompt investigation and energetic prosecution. What has been done up to the present in this matter is not definitely clear, since the SEC reports cover its administration of several acts besides the Securities Exchange Act, but up to June 30, 1940 it had conducted 6,657 investigations, indicted 1,300 persons, and convicted 542.<sup>14</sup>

The individual states, especially New York, can and have curbed speculation indirectly by a judicious system of transfer and other taxes. The heavy transfer tax now in force makes trading for the short term less profitable, and hence less common, and a tax on short stock tends to reduce the frequency of short sales. A suggestion that state laws be passed prohibiting the resale of stock within a short time is full of possibilities. If correctly drawn up, it should discourage, if not eliminate, that trading for the "short swing" which is practically gambling. However, exceptions would have to be made for the odd-lot broker, who in the daily non-speculative conduct of his business makes more "speculative" commitments than anyone else. Likewise, if

<sup>14</sup> The Work of the Securities and Exchange Commission, U. S. Government Printing Office, Washington, 1940, 14.

possible, the present "market-making" activities of the specialist should not be interfered with. In any case, no legislation should be attempted without thorough investigation and expert testimony, and perhaps a preliminary period of trial.

The point to be kept in mind at the end of this discussion, is that the nation has progressed a long way since the days of 1929. Each step in the curbing of speculation has been slow, methodical, and successful. There will, no doubt, have to be further legislation in the same direction, but it should be done at the same pace and in the same manner as that put through in the thirties.

## CONCLUSION

The aim of this thesis has been to separate the component elements which go to make up the ethical constitution of the stock exchange, to examine each of them separately, and thus to avoid the common practice, and resulting confusion of judgment, of trying to evaluate the complex institution of stock speculation in globo. In the first chapter, the exchange was considered merely as a market, and was shown to be a natural and inevitable tendency because of the homogeneity of shares of stock. A single national market also led to the formation of a monopolistic association with a highly complex organization, which is a remarkably near approach to the "perfect market" ideal of the economist. The second chapter undertakes to explain the nature of margin trading and short selling, and tries to free them of the mystery and prejudice in which they are generally shrouded. Margin trading is seen to be no different, fundamentally, from the purchase of real estate, or any other commodity, on a mortgage or time payments. And short selling, although it is dangerous because of the open door it leaves to abuses, is also based on familiar and generally accepted principles of contract or trade.

However, in spite of the legitimacy of the exchange and its approved practices when viewed in themselves, there remains the

fact that speculation has run rampant to such an extent that public authority has, upon various occasions, deemed it necessary to intervene. The first thorough investigation was that of the Hughes Commission of 1909, which found grave abuses, especially in the overexpansion of speculation, but admitted itself unable to eliminate them without unduly penalizing legitimate traders. It contented itself with calling upon the New York Stock Exchange itself to take the situation in hand and remedy it. It remained for the Roosevelt administration of 1932 to formulate laws which would ingeniously eliminate the undesirable elements without too much curtailing the freedom of the market.

Since there has been serious advocacy of the total abolition of speculation, the fourth chapter examines the experience of Germany in its drastic regulation of the Berlin Stock Exchange late in the last century, and of the United States in its attempt to prohibit speculation in gold during the Civil War. Both of these efforts only increased the violence of price changes and offered cover for dishonest practices, showing that legislation may easily aggravate the situation by becoming too drastic. The SEC, on the other hand, has cut down trading on the New York Stock Exchange by one-half or more, without driving it either abroad (as happened in Germany) or to under-cover operation (as was the case with gold in this country during the Civil War). Individual states have also helped to discourage speculation and the rapid turnover of securities by



by heavy transfer and other taxes.

But in spite of all this, there may still be good reason to doubt whether or not the stock exchanges of the country produce more good effects than evil ones. If stocks are bought as investments, their resale should be the exception rather than the rule, and the figures on the turnover of stock shares show that this is obviously not the case. Some provision for a market should exist, but the exchange seems based on the principle that speculative purchases of shares should predominate. But what can be done about it? The experience of history dictates strongly against total abolition, or even drastic regulation. Such procedure is worse than no regulation at all, because it must soon be reversed, and gives the supporters of the stock exchange a talking point strong enough to block all further attempts at reform.

Perhaps the best place to start would be with the individual investor. What institution should undertake to give him a slightly less gullible attitude toward the stock exchange is highly problematical, but that the average investor and speculator needs education and an infusion of prudence is abundantly evident. When the United States went off the gold standard, there was an immediate rush to buy the gold stocks, among them the Yukon Gold Mining Co., and it was not until much later that many hasty investors found out that the Alaskan properties of that company had long ceased to yield any gold, and that the firm had moved, lock, stock, and barrel, over the Pacific to

mine tin in Malaya. Likewise, some people bought Seaboard Air Line (R.R.) under the impression that it was operating airplanes, or Cord Corporation under the illusion that it was manufacturing the Cord automobile, whereas it was really a holding company for Auburn (which made the Cord car) and other smaller properties. To everyone of these investors information, complete and accurate and up-to-date, was easily available, if only he had the initiative to look for it. No doubt the brokers concerned might have been at fault in some instances, but it is not generally politic, or even polite, to ask a customer if he knows what he is doing. And all reputable houses maintain an expensive information bureau for the free use of their customers.

Next to the investing and speculating public, the ones who could do most to reform the stock exchange are the members and brokers themselves. Already the various exchanges of the country have done much to inculcate a public spirit in their members, but among men who are intent upon making their fortune by their unaided efforts and skill, selfish individualism has a strong and tenacious hold. But there is no reason to doubt that conditions will improve gradually, if slowly, especially under pressure from the SEC.

It is with the SEC itself that lies the greatest hope for immediate improvement. The provisions of the various acts which it administers are cleverly contrived, and its own discretionary powers are sufficiently wide to handle any eventual-

ity. What specific new regulations should be made it would be difficult to indicate at this time. The most desirable would seem to be a requirement that every share of stock be held a certain length of time before it could be sold, thus eliminating that "in and out" speculation which is the most wasteful and detrimental. But, as indicated in Chapter IV, a blanket rule would work hardships on the smaller investors, who need consideration most of all. Perhaps the good effects would outweigh the evil, but at least extensive studies should be made before any legislation is enacted.

In all regulation a cardinal point should be consideration for persons and attitudes. If the SEC can gain the good will of the brokers and investing public, its rules and regulations will become effective; if not, they can be largely evaded. The broker and professional trader must be impressed with his civic responsibility, and the investor with the principle that real wealth is produced by labor and not by lucky speculation. Such education is necessarily slow and incomplete, like most other education, but there is no reason for not trying to impart it.

Nor must it be forgotten what has already been done. Within ten years the New York Stock Exchange has been reduced from a much-publicized institution on which millions of people hoped and expected to gain their fortune, and which required the services of thousands of workers, to its present-day status of a half-forgotten adjunct to the nation's economic life, whose broker-members must constantly cut their staffs and merge their

firms in order to stay in business at all. In contrast to the first World War, the present conflict has taken the institution of organized speculation out of the public eye, and has pushed it further and further back into the realm of oblivion until there can hardly be said to be a contemporary stock exchange problem at all. But unless the government of America goes over to some form of state socialism, the problem is sure to arise again, as it did in the twenties, but the next time will find the nation ready for it, having profited by its previous experience and having at hand the means to cope with the situation.

## BIBLIOGRAPHY

General Works -- All works on general economics, money and banking, investments, and finance contain a more or less lengthy discussion of the stock exchange; the following proved most helpful.

Bye, Raymond T., Principles of Economics, F. S. Crofts & Co., New York, 1935.

Fairchild, Fred R., Edgar S. Furniss, and Norman S. Buck, Elementary Economics, Macmillan Co., New York, 1926.

Marshall, Alfred, Principles of Economics, Macmillan and Co., London, 1930, 8th Edition.

Moulton, Harold G., Financial Organization of Society, University of Chicago Press, Chicago, 1930, Third Edition.

Ripley, William Z., Main Street and Wall Street, Little, Brown & Co., Boston, 1927.

White, Horace, Money and Banking, Ginn and Co., Boston, 1935, New Edition by C. S. Tippetts and L. A. Froman.

Works on the Stock Exchange -- Meeker contains an exhaustive bibliography of over three hundred titles. Below are some of the more useful and easily available.

Atwood, Albert, and Thomas Conway, Investment and Speculation, Alexander Hamilton Institute, New York, 1911.

Craig, W. W., and Challie Gore, The Forgotten Fifty Billions, Charles Scribner's Sons, New York, 1935.

Flynn, John T., Security Speculation, Harcourt, Brace and Co., New York, 1934.

Martin, H. S., The New York Stock Exchange, New York, 1919.

McNeel, R. W., Beating the Stock Market, McNeel's Financial Service, Boston, 1929.

Meeker, J. Edward, The Work of the Stock Exchange, Ronald Press Co., 1930.

Moody, John, The Art of Wall Street Investing, The Moody Corporation, New York, 1906.

Ryan, John A., "The Moral Aspects of Speculation", The Church and Socialism, The University Press, Washington, D.C., quoted in J. F. Leibell, Readings in Ethics, Loyola University Press, Chicago, 1926, 517.

Van Antwerp, William C., The Stock Exchange from Within, Doubleday, Page and Co., Garden City, 1914.

Reports --

New York Stock Exchange --

Report of the President, issued annually.

Year Book, issued annually.

United States Federal Government --

Report of the Senate Committee on Banking and Currency on the Securities Act of 1933 and the Securities Exchange Act of 1934.

Report of the House Committee on Interstate and Foreign Commerce on the Same Acts.

Securities and Exchange Commission --

The Work of the Securities and Exchange Commission, 1940.

General Rules and Regulations under the Securities Exchange Act of 1934, 1941.

The Securities Act of 1933.

The Securities Exchange Act of 1934.