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AN ECONOMIC ANALYSIS OF THE BRADY REPORT: PUBLIC INTEREST, SPECIAL INTEREST, OR RENT EXTRACTION?

David D. Haddock †

The “Brady Report”¹ was compiled swiftly following events in October 1987 during which securities prices plunged worldwide. That report urges substantial new regulatory machinery in response to the event that has come to be known as the “1987 market break.” But a disconcertingly large proportion of the findings, conclusions, and recommendations lodged in the report are badly off-target from a public interest perspective.² In the first place, the “market break” of 1987 was no big deal if placed in the perspective of the following year and compared with other similar events in the history of securities exchanges. Since World War II, four other declines in the Dow Jones Industrial Average (DJIA) have been of a larger percentage than the 26.1% difference between the peak of 2722 registered on August 25, 1987, and the level of 2011 attained exactly one year later.³ And all of those declines are minor league by the standards of the 1920s and 1930s.

Moreover, it was the European and not the American markets that were the first to break.⁴ How then can new regulation directed solely at United States securities markets, as is implicit in the Brady proposals, prevent a recurrence? A serious danger exists that such

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I have received helpful comments from Lloyd Cohen, Kenneth Lehn, Roberta Romano, the participants of the Thirteenth Annual Economic Policy Conference of the Federal Reserve Bank of St. Louis, and the participants of the Conference on Regulation of Secondary Trading Markets at the Cornell Law School.

¹ *Report of the Presidential Task Force on Market Mechanisms* (1988) [hereinafter *Brady Report*].

² See Haddock, *The Swiftmess of Divine Retribution, and Its Tendency to Mistake Its Target: An Analysis of the Brady Report*, in *THE STOCK MARKET: BUBBLES, VOLATILITY, AND CHAOS* 179 (G. Dwyer and R. Hafer eds.) (forthcoming).

³ For all the declines, the peak level is used as the denominator for the percentage calculation. At least three additional transitory post-war declines in the DJIA exceeded 23% over very roughly comparable time-spans. And several declines of similar magnitude (up to 69.5%) occurred in the United Kingdom and Japan over the post-war period. See Greenwald & Stein, *The Task Force Report: The Reasoning Behind the Recommendations*, 2 J. ECON. PERSPECTIVES 3-23, Table 1 (Summer 1988).

⁴ See Dwyer & Hafer, *Do Fundamentals, Bubbles or Neither Explain Stock Prices? Evidence From Seven Countries*, in *THE STOCK MARKET: BUBBLES, VOLATILITY, AND CHAOS* (G. Dwyer and R. Hafer eds.) (forthcoming).

introspective regulation will seriously disable our national exchanges in the increasingly competitive world securities market.

Finally, nobody would have protested or called for new regulatory action if the year-long experience had resulted in a 26.1% *increase* in security prices, even if the short-run movements had been equally abrupt.

So why the sudden calls for extensive new regulations for United States security exchanges? In this paper I search for an answer to that question.

I do not deny that the rapid decline during a few days of mid-October startled and troubled market professionals, costing some of them substantial sums (but profiting a few handsomely). So did the several transitory rebounds that interrupted the mid-October slide, and the much more permanent one that came after the DJIA had fallen to almost 1700 by October 20, a level that proved to be the lowest point during the year-long span. And, indeed, it does seem that the clearing arrangements in place in the exchanges were severely taxed during the few days of most rapid decline.

But the most remarkable features of the market break have been the tenacity of the champions of regulatory proposals purportedly designed to "solve" a very small problem, and the continuing highly-publicized attention (but inaction) of Congress toward an event of little interest to most voters—even during the period of most rapid price decline. Though commentators frequently claim that common investors *might* become disillusioned and discouraged by Congress's continuing failure to adopt new controls, the only private citizens who have taken the trouble to participate vociferously in the regulatory debate are market professionals—those who work in close conjunction with the securities markets. And market professionals, of course, have a strong private interest in the regulatory outcome not necessarily consistent with the interest of the economy as a whole.

That observation, of course, raises the possibility that the Brady Report was not even intended as a public-interest document. Perhaps it was motivated by special-interests who are more inclined to rationalize self-serving proposals to a skeptical public than to increase social welfare. Or perhaps it is best seen as a mere threat to act against certain narrowly defined interests in order to extract concessions from those interests in favor of governmental actors—McChesney's rent extraction scenario.⁵ I investigate in turn each of the alternative views of the Brady Report—public-interest, special-

⁵ McChesney, *Rent Extraction and Rent Creation in the Economic Theory of Regulation*, 16 J. LEGAL STUD. 101 (1987).

interest, rent-extraction—in the material below. Identifying the alternative that best characterizes the Brady Report, however, must await the resolution of present Congressional activities.

Although regulatory proposals have arisen from many quarters, the focus of this paper will be on those advanced in the Brady Report, so called after Nicholas F. Brady, the chairman of the Task Force.⁶ It is difficult to state the views of the Brady Commission concisely. On a superficial level, panic, or even hysteria, are the single words that seem to reflect most accurately the tone of the rather disjointed report—perhaps merely reflecting that the report was the work of a committee. Whatever the explanation, the Report devotes long passages to lamenting one inequity or another, without ever suggesting any obvious regulatory “correction.” Some of the regulatory proposals that *are* advanced in the Report seem hardly to have been foreshadowed by those market failings asserted by the Commission. If the Brady Report were a legal brief, the action might well be dismissed for failure to state a cause of action, with the defense not even being required to present a rebuttal.

I

APPROPRIATE RESPONSES TO SYSTEM FAILURE

A. The View of the Brady Report

Implicit in the Brady Report, and in many alternative regulatory proposals, are the following options: (1) cope with events similar to the recent market break by increasing governmental regulation, or (2) do nothing about such events at all. Also implicit is that the second option is profoundly inferior to the first. Finally, it is implicit that the entire episode of the market break represents a conflation of inseparable but confusing events, inappropriately dealt with in a piecemeal fashion. As the Brady Report states: “Analysis of market behavior during the crucial days in mid-October makes clear an important conclusion. From an economic viewpoint, what have been traditionally seen as separate markets—the markets for stocks, stock index futures, and stock options—are in fact one market.”⁷ By implication, no aspect of the problem can be dealt with in an arena that is fundamentally different than that in which any other aspect is approached. The Report urges a coherent, unified approach instead.⁸

⁶ Brady, then an officer of an investment bank, subsequently assumed a high position in the Reagan administration despite having urged increased regulation during the term of a supposedly deregulating administration. Brady remains in the upper echelons of the national government at the beginning of the Bush administration.

⁷ *Brady Report*, *supra* note 1, at 55.

⁸ *See id.* at 59-60:

The October 1987 experience illustrates that regulatory changes, derived

It is urged that non-specialists cannot reasonably hope to understand what has happened in the securities market during the past year.⁹ Consequently, non-specialists cannot understand how the regulatory proposals will help avoid a recurrence of the October terror in the future. Instead, it is necessary to depend on public-spirited specialists to instruct a functionally blind nation regarding appropriate courses of action.

B. An Alternative Viewpoint

I disagree with virtually everything summarized in the section just concluded. At the very least, I assert that the case to back such views has yet to be made, or even begun. And this judgment does not depend on the reason for the market break—a change in fundamentals, the bursting of a speculative bubble, psychological factors, or whatever—nor upon the strength of the efficient market hypothesis.

In the first place, lots of “markets” are interrelated—many of them closely—with no particular need for regulation implied. For example, houses, apartments, and offices are closely related markets. Because most such buildings are covered by mortgages, those markets are closely related to financial markets. Because the construction industry produces houses, apartments, and offices, but also produces highways, bridges, television and radio stations, those markets are interrelated as well. The latter items draw a connection with the entertainment industry—films, plays, recordings—and then on to screenplays and books. In fact, if one had nothing better to

from the one-market concept, are necessary. . . . [It] demonstrates that the issues which have an impact across related markets, and throughout the financial system, include clearing and credit mechanisms, margin requirements, circuit breaker mechanisms, such as price limits and trading halts, and information systems for monitoring intermarket activities. . . .

Moreover, the October break illustrates that difficulties in stocks and derivative market segments produce dislocations in other financial markets. These, in turn, exacerbate the problem in stocks and derivative market segments. . . .

[The newly proposed] intermarket agency must consider the interactions among a wide variety of markets encompassing stocks, stock index futures, stock options, bonds, foreign exchange and the credit and banking system, in both domestic and foreign markets.

⁹ The most fundamental requirement [of the proposed agency] is broad and deep expertise in these market segments and instruments. However, expertise in individual instruments and market segments is not sufficient. The key requirement is expertise in the interaction of instruments and marketplaces as an integrated system. . . .

The critical requirement for the intermarket agency is broad expertise in the financial system as a whole because the greatest potential risk of intermarket failure is to the financial system as a whole, rather than to individual market segments.

do, it would be possible to trace out paths to virtually every market in the world, concluding that they all are part of "one market."

And they are! It is called the economy, and no citizen, not even an Adam Smith, completely understands the economy. Although that may justify studying economics, it does not, in and of itself, justify new regulation. Regulators are not some breed of intellectual supermen who can see through matters opaque to the rest of us—far from it! Consequently, whether or not we employ regulators, losses will befall society that could have been avoided if foresight were as good as hindsight. Thus, an observation that such a loss has just occurred justifies employing scarce resources in new regulatory activity if and only if the regulator will have some advantage over private actors. The Brady Report nowhere addresses this question of comparative advantage. Instead, the report lists platitudes with great thoroughness. The thoroughness of the listing serves only to distract attention from the list's lack of important implications.

Selecting the appropriate response to a trying event, such as the market break, is considerably more complicated and less obvious than the Brady Report implies. In fact, it is often wise to respond to highly unsettling events by doing nothing at all. A non-response is desirable under at least two sets of circumstances:

First, highly unsettling events are often inevitable in the workings of markets as resources are expelled from uses that are less valuable than the alternatives. Such events should ordinarily be ignored. Artificially retaining resources in a present activity denies more valuable activities a full opportunity to expand, a notion known to economists abstractly as a "constraint." Congressional inaction in view of the market break will undoubtedly discourage some investors who have been involved in the market in certain ways ("playing the market"). But that may be all to the good—such people and their funds will not collapse into inaction if they are not playing the market, they will instead turn to other pursuits where they have a comparative advantage. Similarly, brokers will lose income, and some will be forced to find other employment as they lose clients.¹⁰ Again, though brokers will be unenthusiastic about the prospect, that frees resources for the expansion of activities that utilize similar inputs.

Second, even if the event cannot (and possibly should not) be ignored, responses are costly, so they are merited if and only if the total cost of a response exceeds the total benefit, which is the cost borne in the event of non-response. Although one easily observes

¹⁰ See, e.g., *Small-Investor Brokers Lose Clients, Income In Wake of Oct. 19*, Wall St. J., Sept. 26, 1988, at 1, col. 6.

that regulatory responses to anything are vastly expensive propositions, to my knowledge nobody has done even a back-of-the-envelope *empirical* examination designed to determine whether or not October 1987 merits any response.

Moreover, even when the totals warrant some response, the problem being responded to ordinarily will not be obliterated by an optimal response. The *magnitude* of the optimal response will be determined by the marginal cost and benefit of responding. Since the marginal cost is often substantial, the optimal response will equally often be one that retains a substantial probability that some similar events will recur. It is far from clear, particularly with the benefit of hindsight, that October 1987 was anything more than such an "optimal failure" of the system of controls already in place.

Further, even if the marginal empirical analysis (assuming it were attempted) indicated that greater controls on securities exchange mechanisms are desirable, the controls ought to be sought along the least costly avenues. In many instances, that will imply private rather than governmental regulatory controls. The notion that adequate incentives may exist to spur private institutions such as the New York Stock Exchange (NYSE) to continue innovating and developing appropriate exchange controls seems alien to the Brady Report. But even if a new governmental regulatory approach seems desirable, the requisite powers to implement the approach may already be vested in an existing agency, such as the Securities and Exchange Commission (SEC).

Hence, a whole array of plausible responses to the market break exist that involve no major new governmental regulatory action. Only in those instances in which each and *every* one of those alternatives is rejected as being inappropriate does it make sense to divert scarce Congressional attention from other important matters so that some entirely new regulatory structure can be designed and erected. It seems odd, from a public-interest perspective, that the Brady Report urged just such a revamped regulatory structure without ever seriously considering *any* of the alternatives. And it seems odd that members of the Brady Commission continue to bemoan the failure of Congress to act promptly on their proposals despite the continuing scarcity of empirical evidence that the Brady proposals are actually related to the problems the Commission members claim to have perceived during the market break. Apparently, their preferred hardware for conducting empirical investigations is a newspaper printing press.

II

A PUBLIC-INTEREST ANALYSIS OF THE REGULATORY PROPOSALS

The public interest is, of course, a highly ambiguous concept.¹¹ But for the purpose of determining whether or not the Brady Report can plausibly be represented as a public-interest document, it is informative to adopt the relatively lenient Kaldor-Hicks standard.¹² Even under this loose standard, however, it will be shown that serious failings seem to permeate the Brady Report as a public-interest document. The assertions of the Report to the contrary, the actual events detailed seem to imply no need for additional government regulation. Consider some of the major, albeit disorganized, pieces of the Brady Report in turn.

In retrospect, it seems that the recent securities price decline was especially remarkable only for the speed with which events occurred during the several days beginning with October 19. Although the Brady Report discusses the speed of the price decline unfavorably—a “free-fall”—and at length, I believe the Report perceives neither the mechanism that caused the rapid price decline nor its economic importance.

One hypothesis that could explain the unusually rapid securities price decline is that it was merely a drawing from one tail of a distribution describing a stochastic process. That would mean that the speed of the October segment of the 1987 market break implies nothing about future market breaks, and, hence, implies nothing new concerning our understanding of the regulatory environment. Consequently, it implies nothing obvious concerning new regulatory initiatives. This hypothesis has not been refuted. Instead, wild inferences are drawn from a sample of one (increasingly unimpressive) observation.

The most obvious alternative hypothesis that might account for the speed of the October securities price drop is more optimistic. That hypothesis would focus on evolutionary changes in the environment of securities exchanges that simply make things work faster now than they formerly did. In other words, perhaps what happened in 1987 was the same general process that had earlier driven the 36% decline in the DJIA from the end of 1968 through mid-

¹¹ This is known as “Arrow’s impossibility theorem.” See K. ARROW, *SOCIAL CHOICE AND INDIVIDUAL VALUES* (2d ed. 1963).

¹² Virtually every proposal in the Brady Report fails on cursory examination if a Paretian standard were to be selected instead. For definitions of Kaldor-Hicks and Pareto efficient actions, see W. LANDES & R. POSNER, *THE ECONOMIC STRUCTURE OF TORT LAW* 13-17 (1987).

1970, but it just got telescoped—perhaps the process is essentially the same, but we need to deflate our clocks and calendars.

Several examples of evolutionary changes that plausibly could speed market processes were specifically pointed to by the Brady Report,¹³ including the initiation of block-trading and portfolio insurance. As Greenwald and Stein¹⁴ note, however, such mechanisms seem not to be implicated: similar market breaks occurred abroad even in markets and for financial instruments for which block-trading and portfolio insurance were absent.

But suppose that Greenwald and Stein are mistaken about the contribution of portfolio insurance to the events of October. Even so, those portfolio insurance sales that occurred in the early part of the break were inappropriate from neither a private nor a social point of view—in retrospect it is seen that those sales extricated clients from the lower prices that soon prevailed (privately appropriate), and they drove securities prices more quickly toward a new equilibrium (socially appropriate). If portfolio insurance strategies led to inappropriate mechanical dumping of portfolios late in the market break, that would have contributed to the overshoot that was ultimately observed (socially inappropriate). But it also would have contributed to decreasing the wealth of the subscribers (privately inappropriate), so the market will issue retribution to the portfolio insurance firms where suitable (socially appropriate). In fact, portfolio insurance is now approximately one-quarter the size it had attained prior to the market break. There seems to be no task left with respect to portfolio insurance for a regulator to perform.

An alternative example of a suspect evolutionary change that would have compressed market time is a general increase in the rate at which communications of various sorts now proceed, due possibly to advances in electronics, satellite transponders, computer software, etc. Since essentially everyone agrees that the expected profitability of firms at least influences securities prices—if it is not the entire determinant—then increasingly rapid communications that drive the DJIA more promptly toward a new equilibrium in the face of new information is not a social ill at all, but rather a boon. This is not to deny that rapid movements in prices will inevitably prove a problem for certain individuals. But the gains to the winners will exceed the losses of the losers, which ends the debate under the Kaldor-Hicks notion of social welfare adopted in this paper. Securities prices influence decisions regarding new investment. If new information implies that investment plans should be reconfigured, the quicker that information becomes widely known the

¹³ See Brady Report, *supra* note 1, at 15-21.

¹⁴ Greenwald & Stein, *supra* note 3.

fewer the inappropriate projects that are initiated. Given the rate at which new real investment is initiated, even a rather brief delay can lead to serious misallocations in an absolute sense.

Nevertheless, the Brady Report indicates that the rapidity of the decline was one of the "problems" associated with the market break.¹⁵ Similarly, the Report laments the failure of some exchange specialists to "lean against the wind." When the market is moving toward a new equilibrium, as hindsight says it was during most of the market break,¹⁶ specialists serve neither their own nor social purposes by leaning against the wind, although, of course, that would benefit certain individuals. From a social viewpoint, if specialists know where the market is ultimately headed, they should lean *with* the wind until it reaches the new equilibrium in order to attain that new equilibrium as promptly as possible. And they have private incentives to do just that.

Under the efficient market hypothesis, even in its weak forms, the behavior of specialists who were buying on net before the market reached a new equilibrium was as injurious as net sales by specialists after the new equilibrium had been passed. Either sort of behavior delays the stabilization at a new equilibrium, so either one prolongs the period of erroneous investment decisions that result. Yet to the Brady Commission the former is "good" behavior, while the latter is "bad."¹⁷ In retrospect one can surely find instances in which specialists sold at prices below the ultimate, new equilibrium, and others in which they bought at prices above the new equilibrium. But that will have proven privately costly to them, and so it indicates only that the foresight of specialists is imperfect, as would have been the foresight of anyone caught in the midst of the decline. There is no externality worth worrying about. Because such trading is privately costly to specialists, one may assume the specialists themselves will undertake any improvements in their techniques that are worth more than they cost. It is doubtful that a regulator could adopt a superior *modus operandi*.

¹⁵ See *Brady Report*, *supra* note 1, at 15-41.

¹⁶ Two-thirds of the fall in the DJIA between the peak on August 25, 1987 and the trough on October 20, 1987 had not been recovered by August 25, 1988.

¹⁷ Actually, the Brady Commission laments net sales by specialists that occurred either after the new equilibrium had been passed—a genuine social bad—or before the new equilibrium had been reached—a social good. The Brady Commission seems to view market specialists as some bizarre insurance mechanism that permits investors to capture the benefits of every increase in securities prices, but absorbs all the losses whenever the securities prices decline. As I see their role, specialists are merely inventory managers, and as such enable markets to function continuously even when buyers and sellers do not appear on the market in perfectly offsetting flows. Inventories are extremely valuable economic tools, but they are quite distinct from the mechanisms of the insurance industry.

Even if one assumes that the events of October were entirely the result of the bursting of a speculative bubble, and that no new information was implicated at all, the appropriate response would seem to be rather trifling in comparison with the proposals of the Brady Report. The appropriate guard against similar events occurring in the future would seem to be better definition of the mechanism through which the bubble forms, and wide distribution of a concise and clear explanation to the public. Maybe "bubble warnings" could be issued by anyone wise enough to foresee one—although one wonders why that wise person would not simply sell short, make a fortune, and help initiate an early bursting of the bubble while it was still small. Most investors are risk-averse, and would simply withdraw into a "safe-harbor" whenever a credible bubble warning was issued. If some investors are willing to gamble on being better than most at timing a break—and a gamble is exactly what a net long position would imply when a bubble was in existence—it would seem inappropriate to gear the regulatory structure simply to prevent the gamblers from exercising their wishes.

But if new and better understanding is the solution to speculative bubbles, no additional regulatory structure is implied. The SEC, for one, already possesses ample authority to undertake and publicize studies of speculative behavior, while universities and investment banks require no authorization in the first place—at least not in this country.

A similar response seems called for to deal with the inappropriate reversals and eventual overshoot of the market during the market break. After all, that is hardly a new phenomena. If such events could efficiently be predicted with greater precision (that is, if there was anything a new regulator could do to prevent them at a cost worth bearing) other people in the market would have taken advantage of the opportunity already—and would now be wealthy. Hence, while continued investigation of the phenomena is difficult to oppose in principle, institutions that are already in place seem to possess adequate authority and incentive to continue at an appropriate rate a process long since initiated.

A problem that did arise during the 1987 market break, and that apparently was related to a new-found speed of communication, arose from an imbalance of communications. The rate at which the electronic technology at the exchanges could cope with information flowing in from outside was less than the rate at which the outside world could feed in the information. The imbalance contributed to long delays in executing orders, and thus to substantial deviations between price quotations when orders were placed and the transaction prices actually realized when the orders were executed. That,

of course, leads to poor investment decisions of another sort—not directly with respect to real investment, but with respect to portfolio management decisions. Moreover, those investors with better access to new communications equipment had better luck at getting their orders executed than those who were still relying on older technologies—such as simple telephone conversations—at least early in the break.

But the appropriate response to such an inability of the exchanges to cope with a burst of incoming orders would seem to be either none or private. It does not make sense to build storm cellars in counties where tornadoes occur once a century, even if one has just hit one of the county's towns. And it does not make sense for exchanges to invest in more sophisticated and more expensive electronics if the imbalance discussed in the paragraph above is rare.

If it *does* make sense to update the communications technology of the exchanges, however, and very possibly it does, the planning and implementation can sensibly be made by the exchanges themselves. The exchanges have a profit motive for making good decisions about how much, what kind, and how soon, and about the appropriate level of communications inter-ties to form among independent exchanges. Supplanting markets with regulation is usually rationalized in an abstract setting by hypothesizing external effects that no private individual can internalize profitably, but it is difficult to detect such an externality here.

In contrast, a government regulator will respond to political incentives. Political responses tend to be more episodic than market responses, less expert, less dynamically sensitive to the evolution of the social and technological environment, and more prone to become hostage to special interests and unrelated policy concerns.¹⁸

Furthermore, in the absence of a revealed Pareto-relevant externality,¹⁹ a regulatory "solution" creates rigidities that can frustrate attempts to reach the *best* solution.²⁰ Anything that a regulation is effective at mandating, a private institution is capable of selecting voluntarily. No option is lost by failing to mandate a specific action. In the absence of an externality that cannot be pri-

¹⁸ Some evidence indicates that regulatory efforts retard rather than accelerate the implementation of new technology. See Macey & Haddock, *Shirking at the SEC: The Failure of the National Market System*, 1985 U. ILL. L. REV. 315.

¹⁹ Buchanan & Stubblebine, *Externality*, 29 *ECONOMICA* 371 (1962).

²⁰ If the regulatory action leads to a demonstrable improvement over the preexisting situation, its proponents will trumpet the "success" of the regulation. Such a tack ignores the proper standard of comparison, which is not inaction, but rather includes the private actions that would have occurred had they not been preempted by the regulation. Unfortunately, the counterfactual cannot be observed directly, since the regulatory mandate will insist on the mandated state of the world.

vately internalized,²¹ the profit motive leads individuals to attempt just such a selection unless another option is superior. If the initial choice is mistaken, private parties can quickly revise their selection, and competition among them will promote such a revision by the ultimately successful individual.

In contrast, if a mandated regulatory response is mistaken, private parties are compelled to select it nonetheless. And since regulatory agencies are legal monopolies, proximate competition cannot correct the error. If competition is to play any role at all, it must come via competition for the jobs of elected officials who oversee the agency. But that sort of competition will be seriously diluted among all sorts of other political concerns. Legislators rarely if ever win or lose seats because of a failure to keep a tight enough rein on some "independent" regulatory agency.²²

It is also claimed in the Brady Report that small investors were particularly disadvantaged by communications failures. During the market break, small investors, who lacked direct ties to securities markets, often could not get their orders executed for substantial periods. In the terminology of the Brady Report, investors could not withdraw from the market in a timely fashion.²³ In some instances, that phenomenon arose from a straightforward inability of the system to process orders at a rate equivalent to the rate at which investors were trying to execute them. But in the over-the-counter market the inability of investors to execute orders sometimes arose from another source—the total disappearance of market makers. Because nobody in the over-the-counter market has an obligation to make a market, many of those who ordinarily do simply decided not to do so during the market break.

But the failure of such individuals to make market implies that they were trying to evaluate the ultimate impact of the break. Otherwise, they could simply have moved to the new equilibrium price but continued to make market, thus earning the bid-ask spread on all the transactions that, in fact, they failed to make.²⁴ Moreover,

²¹ Coase shows that, though it is child's play to observe some externality-producing situations (and imagine countless others), it is all too frequently ignored that the vast majority will be internalized by cognizant human beings. Coase, *The Problem of Social Cost*, 3 J.L. ECON. 1 (1960).

²² See McChesney, *supra* note 5.

²³ See Brady Report, *supra* note 1, at 48.

It seems to have escaped the notice of the Commission members that to the extent that one of these people had found a way to withdraw at a higher price than he actually received, that would have meant that someone else would have taken a bigger loss. In other words, the complaint is merely one that the losses were not distributed in some alternative way. The Report makes much of the undeserved losses that some individuals suffered, but says little about who deserved to absorb those losses instead.

²⁴ This is evidence that the efficient market hypothesis must be adopted in a weak

investment banking firms most often are those who serve as market makers for over-the-counter securities. Since the opportunity cost of their resources had temporarily increased as the firms scrambled to keep abreast of events occurring on the exchanges, their withdrawal from the typically lower-volume over-the-counter markets may well have represented an efficient reallocation of resources.

Even with respect to the organized exchanges, where the markets for individual securities continued to function most of the time, the concern for small investors is largely misplaced. According to the Brady Commission, a limited number of investors seemed to drive the market down. But that observation is an *implication* of the efficient market hypothesis. Most investors place funds in securities because the life-cycle of earnings does not mirror the life-cycle of consumption too closely. Parking savings in securities for the stream of dividends and capital gains they yield is superior to parking them under the mattress. Only a few investors “play” the market, trying to make money more rapidly than the typical investor by buying before a market rises and selling before it falls.²⁵

Such a distribution of investor types is sensible. Information is a public good, and so for any one security only a few individuals should make the substantial investments necessary to collect and appropriately process the complex flows of information that arrive into the market. When the information indicates that little change is called for, these “information specialists” have no incentive to trade, and the trading activity overall will then be dominated by portfolio adjustments that “time-function traders” make while bringing their fluctuating incomes into balance with their even more variable expenditures.

The activities of time-function traders will be largely unchanged by inflows of new information—they cannot hope to be first to learn of it, so all profit would be drained before they could act.²⁶ But the behavior of those few individuals who specialize in processing information will be affected by new information. Since, by definition, they are the first to learn and understand the new information, they can profit by acting on it. Hence, the proportion of transactions that involve information specialists will increase with the rate of new in-

enough form to embody a period for information digestion that is measured in days, even weeks, in some instances. But while such an observation has some intellectual implications, it seems to have no regulatory ones.

²⁵ See, e.g., H. MANNE, *INSIDER TRADING AND THE STOCK MARKET* (1966).

²⁶ Haddock & Macey, *Regulation on Demand: A Private Interest Model, With an Application to Insider Trading Regulation*, 30 J.L. ECON. 311 (1987) [hereinafter *Regulation on Demand*]; Haddock & Macey, *Controlling Insider Trading in Europe and America: The Economics of the Politics*, in LAW AND ECONOMICS AND THE ECONOMICS OF LEGAL REGULATION 149 (J.M. Graf von der Schulenburg & G. Skogh eds. 1986) [hereinafter *Controlling Insider Trading*].

formation inflow. This only implies that people try to exploit their comparative advantages, and that is both privately and socially appropriate.

It is claimed in the Brady Report, and I will accept as fact, that the clearinghouse arrangement in the securities market was threatened by insufficient liquidity until it was rescued by the Federal Reserve System. In particular, since debiting and crediting of accounts takes time, some participants were threatened with insolvency because they were not receiving credit due promptly enough to maintain adequate balances with the clearinghouse to cover margin calls on other positions. This problem is alleged to have been particularly acute because different clearinghouses provide their services for different securities market segments, and the different segments maintain interlinks that were too tenuous.

But private institutions operating in the securities markets have an incentive to avoid temporary breakdowns of their clearing arrangements. Their world would not collapse if the clearinghouse became overloaded, but trading would be slowed or halted while the failure was rectified, with a loss of commissions and trading opportunities in the meantime. If a regulator can imagine and implement an alteration that makes such a breakdown less likely, why cannot the private institutions imagine and implement the same alteration?

Perhaps the Brady Commission's concern about the clearinghouse mechanism is, in fact, well-placed. Perhaps the private incentives are not strong enough to induce an appropriate revamping. A private revamping of the clearinghouse mechanism would entail private costs, but experience reveals that the Federal Reserve will bail out the clearinghouses at moments of crisis, as it did in October of 1987. If that is the source of a problem,²⁷ however, the appropriate alteration in public policy would be to direct the Federal Reserve to take a hands-off approach in the future, and to announce such an alteration in policy to the exchanges.²⁸ That would give exchange institutions full incentive to take efficient advantage of technical op-

²⁷ I suspect that at least a good part of the problem (and conceivably all) is simply that the clearinghouses have not completely adapted to new communications technology and to new market segments. Private adaptation will take time, but probably less than a regulator would take to do the same task.

²⁸ Clearly, it is desirable for the Federal Reserve System to insure that a sudden and substantial decrease in liquidity does not occur economy-wide. The "quantity theory of money" implies that such an impact on liquidity would be mirrored by a substantial decrease in the rate of economic production. But that does not imply that infusions of liquidity need go directly to clearinghouses. Nor does it imply that the liquidity that does reach the clearinghouses through private banks should be priced at anything other than what the market dictates for other demanders of similar riskiness. In other words, the plight of the clearinghouses did not imply that they should be blessed with preferential treatment by the Federal Reserve.

portunities. Contrary to the suggestions of the Brady Report,²⁹ the "Fed" needs no overarching new regulatory authority over securities exchanges to carry out such a task.

Finally, the Brady Report suggests coordinating margin requirements across exchanges, and coordinating "circuit breaker mechanisms"—trading halts and the like. These are the most difficult suggestions to dismiss. *If* it is desirable to have unified margin requirements and unified trading halts, then they will not arise without coordinated action among the various market segments. A high margin requirement or a trading halt in only one exchange will merely divert transactions onto other exchanges, so that the exchange with the most lenient attributes will determine the *de facto* attributes for all exchanges. It remains to be shown, however, that this competition among exchanges is socially injurious.

Suppose, however, that one or both can be shown to be injurious to investors. If that is so, some capital that would otherwise be invested in securities will be diverted to other uses. Consequently, firms that wish to use the capital markets to raise funds would like to guarantee that their securities would be traded only on exchanges with appropriate margin requirements and/or trading halt protocols, because that would increase the price for which they could sell their securities when they are issued.

But if my reasoning is correct, what is wanted is a modification of SEC policy that now permits cross-listing of securities by one exchange whenever the security is listed on another exchange.³⁰ The appropriate modification would require that the firm whose securities are to be cross-listed authorize the cross-listing. In a similar fashion, firms should be enabled readily to delist their securities from an exchange whose trading practices begin to displease them.³¹ If the firms issuing securities could confine their listings to the exchange(s) which they selected, competition among exchanges

²⁹ See *Brady Report*, *supra* note 1, at 62-63.

³⁰ A security comes to be traded on an exchange in one of two ways. A company may file an application with the exchange and be accepted for listing. Alternatively, subject to SEC approval, an exchange unilaterally can trade securities not listed on that exchange, regardless of whether the issuer has applied for or even desires a listing with the exchange.

Macey & Haddock, *supra* note 18, at 329 (citations omitted).

³¹ [E]xchange rules, with full SEC support, make it extraordinarily difficult for a listed company to delist voluntarily. . . . The NYSE delisting guidelines, which an issuer must satisfy under section 12(d) of the 1934 [Securities Exchange] Act before applying to the SEC for deregistration, provide that two-thirds of the issuer's shareholders must vote to delist, and no more than ten percent can oppose such delisting. Furthermore, the [Securities and Exchange] Commission sometimes requires a majority vote of the shareholders *per capita*.

Id. at 350 (citations omitted).

would lead to an optimal configuration of margins and trading halts, as well as other improvements in exchange practices. Again, no new regulatory authorization is required, just an alteration of the rules under old authorization.

III

A SPECIAL-INTEREST ANALYSIS OF THE REGULATORY PROPOSALS

In contrast to a public-interest analysis, if the null hypothesis is that the Brady Report is a special-interest document, the specific nature of the Report's factual predicates are of little interest. The elemental special-interest model focuses on variations in concentration across interest groups.³² *Ceteris paribus*, interest groups that are relatively concentrated have an advantage in obtaining redistributive regulation, even if the regulation leads to some deadweight losses. Concentrated interest groups will have more at stake per individual. That is seen as increasing the likelihood that they can rationally undertake a larger investment to achieve favorable regulation than can competing groups, such as the general public, assuming that the costs of organizing are a function of the number of individuals to be organized.

But then, if the Brady Report is indeed a special-interest document, the elemental model leaves one wondering why the Report contains any fallacious predicates at all. If relative concentration is the whole story, the Report would simply say: "The following are the concentrated interest groups, and our regulatory proposals benefit them in the following ways."

A. The Complexity Factor

If "mud-slinging" campaign tactics have a rational basis, however, it must be because politicians who consistently vote favorably for proposals that blatantly favor special interests over the public-interest have a poor expectation of reelection. Even the unconcentrated general public will react negatively if it becomes clear that an incumbent frequently acts against their interests, even if the per capita cost of each act is modest. Consequently, it would seem that any organizational advantage concentrated interests have over dispersed ones is insufficient to explain special-interest regulation. For concentrated interests to dominate dispersed ones in obtaining favorable regulations, it must be that the concentrated interests suf-

³² Peltzman, *Toward a More General Theory of Regulation*, 19 J.L. ECON. 211 (1976); Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971) revised and reprinted in G. STIGLER, *THE CITIZEN AND THE STATE: ESSAYS IN REGULATION* (1975).

fer less from “rational ignorance.”³³ Due to the greater per capita stake of concentrated interest groups in regulatory outcomes, it is more likely that the members of the group will actually understand what the regulatory proposals imply.

Such an observation yields two empirical predictions:

First, regulation favorable to any interest group will have a higher probability of adoption if the regulated sphere is complex than if it is superficial. The relevant interest group will already understand the complex workings of their market because that is required to work there successfully. But the general public will be deterred from acquiring a similar understanding, because the information will be of limited future usefulness to them.

Second, the proponents of special-interest regulation actually have an incentive to increase the complexity of the regulatory proposals, because the special interests have a comparative advantage in sorting through the intentionally convoluted reasoning.³⁴ One way that complexity can be increased easily is by leaving out steps in the logic of the argument, steps that are easily filled in by members of the favored interest group, but which can be discovered only with difficulty by those with no preexisting institutional knowledge. Note carefully that the argument will not be intentionally *illogical*—chance discovery of obvious illogic would discredit the entire proposal. Instead, the missing steps will be held in reserve, to be publicized one by one (only as necessary) to discredit critics of the proposals. Moreover, the regulatory proponents actually have an incentive to advertise the complexity of their arguments to dissuade critics and non-favored groups from even initiating a study of the proposals.

The Brady Report seems suspect on both predictions. First, the securities markets are indeed difficult for ordinary individuals to understand. The items traded are abstract, trading techniques are unusual if not unique, the speed with which transactions are executed is staggering, and the markets are highly centralized and beyond the experience of the vast majority of the public. Moreover, that an interference with the market could impair real, as opposed to nominal, productive investment economy-wide would come as a surprise to the majority of the population. Second, the circuitousness and leaps of logic (but rarely overt illogic) of the Brady Report are consistent with the special-interest model, as are the repeated assertions

³³ Rational ignorance occurs whenever the expected cost to an individual of acquiring an understanding of some process exceeds the benefits that can be expected to flow to the individual from that understanding. In that event, the individual will rationally choose to conserve scarce resources for other opportunities and to remain ignorant of the process at issue.

³⁴ Haddock & Macey, *Regulation on Demand*, *supra* note 26, at 319-24 make a similar point in a more formal way.

(advertisements) that problems of securities markets require a holistic approach, and ought not be addressed at all by those who are unwilling to understand the entire institutional edifice.

B. The Regulatory Proposals of the Brady Report

Still, if the Brady Report is to be credibly seen as a special-interest document, it is necessary to account for each of its regulatory proposals. To do this, it is necessary to identify the interest groups that are hypothesized to have the favor of the authors of the regulatory proposals. It is commonly hypothesized that the securities exchanges themselves and the market professionals that work on them—specialists, arbitragers, brokers, etc.—comprise the favored interest group.³⁵

The regulatory proposals to be considered include:

(1) A single regulatory agency should supersede the several that presently have overlapping jurisdiction in the securities markets—at least for the areas of overlap.³⁶ (2) The single regulator should be the Federal Reserve System.³⁷ (3) Clearing and credit mechanisms should be unified.³⁸ (4) Margin requirements should be made homogeneous across markets.³⁹ (5) A common circuit breaker mechanism should be adopted across competing exchanges.⁴⁰ (6) Improvements in intermarket information systems should be designed and implemented.⁴¹

1. *Single Regulatory Agency*

At present, several separate agencies regulate different aspects of the securities markets, the most important being the Securities and Exchange Commission, the Commodity Futures Trading Commission, and the Federal Reserve System. Initially, the various agencies were intended to regulate largely non-overlapping

³⁵ See, e.g., Jarrell, *Change at the Exchange: The Causes and Effects of Deregulation*, 27 J.L. ECON. 273 (1984).

One of the major weaknesses of the special-interest model is that it contains no internal mechanism for identifying the favored interest group. As a result, the model seems dangerously close to irrefutability. If one hypothesized interest group is shown empirically not to gain from a particular regulatory outcome, that does not necessitate rejecting the model as a whole, but merely rejecting the subordinate hypothesis regarding the identity of the favored interest group. McChesney, *supra* note 5, has argued that in at least some instances there is no favored interest group, yet the outcome resembles that predicted by the special interest model. I shall return to this possibility below.

³⁶ See *Brady Report*, *supra* note 1, at 59-63.

³⁷ *Id.* at 62-63.

³⁸ *Id.* at 64.

³⁹ *Id.* at 64-66.

⁴⁰ *Id.* at 66-67.

⁴¹ *Id.* at 67.

spheres, but as new securities instruments and trading techniques evolved, private organizations that were primarily regulated by one of the agencies began to encroach on the activities of organizations regulated by another agency.

Under the special-interest model, agencies are perceived to be (or at least become) unduly sensitive to the interests of the firms that the agencies regulate. Consequently, competition among the agencies can replace (although admittedly in a weakened state) the competition among the private organizations that the regulation was intended to suppress. In order to halt the newly emerging competition, it is desirable to the various special interests that they be regulated by a single agency. In other words, the regulation then provides valuable cartel enforcement rather than creating an oligopoly of agencies, each struggling for greater political influence for itself.

Clearly, any one narrowly defined special-interest would prefer to have an agency that would allow that group to encroach on other interest groups, while at the same time preventing the reverse encroachment, and preventing intragroup competition. But it is impossible for each interest group to obtain such favorable treatment, and a simple curtailment of intergroup and intragroup competition will often be the best outcome that is attainable.⁴²

2. *The Federal Reserve System as Securities Regulator*

During the market break of 1987, the clearing mechanisms, which are creatures of the exchanges, were severely strained. It appeared that clearing might have to be halted temporarily while debits and credits were worked out. In the meantime many margined traders would be unable to establish their creditworthiness, and so would have been unable to trade. Market professionals would consequently have missed profitable trading opportunities.

How nice it would be if an organization that is literally empowered to print money could be given the responsibility for seeing that the market remained open and functioning on a "orderly basis." How nice not to be forced to adjust the operations of the clearinghouses to optimally face modern technical realities. How nice not to face the test of the market, which, of course, sometimes calls for the actual failure of institutions that prove unable to properly adjust to market demands. Obtaining the Federal Reserve as the regulator of the exchanges has obvious advantages for those interested parties over merely expanding the regulatory overview of the SEC, or one of the other agencies that is specialized to exchange regulation.

⁴² See Peltzman, *supra* note 32.

3. *Unified Clearing and Credit Mechanisms*

If regulated firms are prevented from competing on price, non-price competition has a tendency to increase until supercompetitive profits are dissipated at the margin. That dissipation can be eliminated if other product attributes can be homogenized. Hence, before the airlines were deregulated, even the meals and movies that could be offered passengers were controlled. In the same way, the special-interest model would view the proposal to unify clearing and credit mechanisms as an attempt to suppress non-price competition on those product attributes.

4. *Homogeneous Margin Requirements*

The special-interest explanation for homogenizing margin requirements is the same as that for unifying clearing and credit mechanisms.

5. *Common Circuit Breaker Mechanisms*

The same argument applies still again. But in this instance an interesting side-light exists that merits some exploration. It is unclear that securities-issuing firms, as opposed to securities-trading firms, benefit from circuit breakers (trading halts) at all. The liquidity of a security is impaired by a trading halt, so one who is likely to require funds on short notice will be more inclined to select alternative financial instruments if trading halts become more common and of longer duration. Assume, for the sake of argument, that securities-issuing firms would prefer that trading in their securities never be halted, *ceteris paribus*.⁴³ As I argued above, if the security were traded on any exchange that never halted trading, that would become the effective protocol for all markets. A trading halt on one market would merely divert trades to the market that was still open, as in fact happened on numerous occasions during October 1987.⁴⁴

But trading halts do not occur randomly. Market professionals govern the securities exchanges, not investors as a group. Ordinarily some market professional possesses the best information available for the securities in which the professional specializes. When trading patterns begin to indicate that other market participants

⁴³ Lester Telser argues that prudent trading halts may, in fact, benefit ordinary investors by providing a period during which margins can be reevaluated, thus avoiding a mechanical selloff by brokers. In that event, security-issuing firms would select an exchange for their securities that would institute trading halts at appropriate moments. See Telser, *October 1987 and the Structure of Financial Markets: An Exorcism of Demons*, in BLACK MONDAY AND THE FUTURE OF FINANCIAL MARKETS (R. Kamphuis, R. Kormendi & J. Watson eds. 1989).

⁴⁴ See *supra* text accompanying note 30.

may temporarily possess information that is superior to that of the professionals, trading is halted until the professionals can catch up. In other words, trading proceeds whenever the professionals possess an informational advantage over their trading partners, but it halts when the professionals are at a disadvantage. If a given security is traded on numerous markets, the most liberal trading protocol dominates, and the professionals cannot avoid lost opportunities while they attempt to acquire information.

Seen in this light, the demand for common trading halts is not just an effort to prevent non-price competition among exchanges for the business of securities-issuing firms. It is also an attempt to reduce the relevance of periods during which market professionals are at an informational disadvantage vis-a-vis their trading partners. But the latter actions simply redistribute gains toward and losses away from market professionals in their dealings with other market participants who may temporarily possess informational advantages.

6. *Improved Intermarket Information Systems*

It is difficult to oppose improved information. That seems tantamount to supporting stupidity. But surely many well-meaning people oppose improved flows of information of certain sorts to the Russians, the Mafia or Iran. The crux of the matter is not whether or not one favors a return to the dark ages, but whether or not one expects the information to be put to socially destructive uses.

Much of the information collected by securities exchanges is used to detect and punish insider trading. Similarly to the argument just completed, when insiders trade on the basis of non-public information, market professionals are caught at a disadvantage, unlike the usual situation in which the market professionals possess an advantage over their trading partners.⁴⁵ In consequence, in some versions of the special-interest model the market professionals are seen as demanding that the SEC act to reduce the extent of insider trading.⁴⁶ One way to identify suspected insider trading cases is to examine trading records for suspicious patterns—for example, large trades in a particular security that have been executed shortly before an unusually large change in the security's price.

The SEC is hampered in its anti-insider-trading effort by poor information about who is actually trading. For instance, the continuing efforts of the United States to coerce an alteration in Swiss law concerning numbered bank accounts are overtly an effort to obtain better information about insider trading in the United States that at

⁴⁵ Haddock & Macey, *Regulation on Demand*, *supra* note 26, at 318-19; Haddock & Macey, *Controlling Insider Trading*, *supra* note 26, at 151-54.

⁴⁶ See Haddock & Macey, *Regulation on Demand*, *supra* note 26, at 329.

present is hidden from the SEC's view.⁴⁷ In a similar way, an ability by a single party to spread a given volume of trades over various market segments makes it more difficult to detect unusual trading patterns. If so, the SEC and the interest groups that would suppress insider trading will seek improved information flows across market segments.

But others have argued that insider trading benefits the economy, quite apart from the redistributive consequences on the exchanges.⁴⁸ If that is true, one may legitimately oppose the expenditure of resources for the sole purpose of improving information flows from securities exchanges to a regulatory agency.

In summary, it seems possible to construct a special-interest explanation for each of the regulatory proposals of the Brady Report. Whether or not one views those constructions as plausible, however, will likely depend on one's predisposition towards the underlying special-interest model.

For example, suppose the regulatory proposal of the Brady Report had been that the SEC should be the single overarching regulatory agency. It would have been easy to formulate an argument to account for that. Indeed, it would seem easier to account for the SEC in that role than to account for the Federal Reserve. After all, many of the special-interests hypothesized to be at work already have a firmly established working relationship with the SEC, whereas the Fed has a broad constituency of its own that is not yet entrenched in the securities markets. In a similar vein, a proposal that intermarket information systems be suppressed would be easily "explained" as a market segmentation device.

In other words, when viewed critically, the near-irrefutability of the special-interest model, as presently formulated, begins to emerge. That does not mean the model is necessarily wrong, only that at present it is seriously incomplete as a scientific construct.

IV

A CONGRESSIONAL RENT EXTRACTION ANALYSIS OF THE REGULATORY PROPOSALS

Perhaps the major difficulties with explaining the Brady Report as either a public-interest or a special-interest document are accounting for the continuing inaction of Congress in implementing the recommendations of the Report, and accounting for the apparent efforts of the exchanges themselves to implement private re-

⁴⁷ See Haddock & Macey, *Controlling Insider Trading*, *supra* note 26.

⁴⁸ MANNE, *supra* note 25; Carlton & Fischel, *The Regulation of Insider Trading*, 35 STAN. L. REV. 857 (1983); Haddock & Macey, *A Coasian Model of Insider Trading*, 80 NW. U.L. REV. 1449 (1986).

forms ostensibly as a substitute for governmental action. In the meantime one observes continuing hearings by Congress, statements that drastic action will be necessary, etc.

Contrary to the ordinary public-interest and special-interest models, McChesney's model predicts just such behavior.⁴⁹ McChesney sees regulatory agencies not (solely) as cartelizing devices that increase the profits of the regulated firms, but also as tools through which Congress threatens private organizations. The threats, it is argued, invite the threatened organizations to "pay off" Congress—through campaign contributions, employment opportunities for favored constituencies, etc.—in order to be spared from the threatened actions. If the Congressional threats are credible, then Congress cannot simply say subsequently that "They paid us off, so we are shelving the action for the time being." The public is not rationally that ignorant. Instead, Congress must be able to point to "solutions" to the "problem" that ultimately seem not to require regulatory intervention. "They managed to put their own house in order, so it will not be necessary to burden taxpayers with additional regulatory apparatus at this time."

Under this "rent extraction" scenario, the Brady Report may ultimately bear little or no fruit in terms of implemented regulations. That will not mean that the Report has had no meaningful economic impact, however. Paying government not to regulate in a damaging manner is a cost to private organizations. The observation that the alternative would have proven even more costly implies only that the economic distortion has been controlled, not that it has been avoided.

CONCLUSION

In my own mind, I am left finally with no strongly-held conclusion of the proper way to characterize the Brady Report.

If the Brady Report was intended to be a public-interest document, then it seems to be a poorly-reasoned and poorly-informed one. The recent market break seems indeed to call for substantial changes in public regulatory policy, but hardly of the form envisioned by the Brady Commission. For instance, the Federal Reserve System should make it clear that, contrary to its behavior during October 1987, it will not intervene in a pinch to save clearinghouses from their own failures to make adjustments in practices as the environment evolves. That will afford the clearinghouses themselves appropriate incentives to undertake any efficient alterations in their operations that are required to speed clearing across exchanges.

⁴⁹ McChesney, *supra* note 5.

Similarly, the Securities and Exchange Commission should take advantage of securities-issuing firms' own incentives to seek efficient securities trading environments for their issues. That can be done by permitting the firms to veto cross-listing of their securities by exchanges they have not selected themselves, and by enabling them to delist more easily than is now possible. Some may counter that such a policy will constrain competition among exchanges. And it will—but in exactly the same way that any other contractual arrangement constrains competition *after the contract is concluded*. That does *not* constrain exchanges' incentives to compete *ex ante*. To the contrary, it *enhances* that competition. As it stands today, exchanges do not have to compete for listings by developing better exchange practices from the viewpoint of the listed firms.

Alternatively, if the Brady Report is a special-interest document, one wonders why its enactment is being delayed. The general public seems bored by the entire spectacle of the hearings, so it seems unlikely that there would be a backlash if Congress implemented the Report's regulatory proposals. Indeed, since the public is so disinterested in this matter, it would seem desirable under the special-interest hypothesis that Congress go about its business very quietly to avoid attracting attention to an activity which, by hypothesis, is so socially disreputable. Consequently, under the special interest hypothesis the widely-publicized hearing process itself is very mysterious in this instance.

Perhaps that implies that the rent extraction model is the correct one, or perhaps some combination of models is required. Perhaps those few aspects that deal with transparent matters (*e.g.*, bubble detection and warnings) are addressed by the Brady Report in a publicly-interested fashion. More subtle issues (*e.g.*, seeking a single regulatory agency) may be motivated by special interests, while still other proposals (*e.g.*, proposals to remove the New York Stock Exchange's independent authority to establish its own trading halts) may be designed to elicit a payoff in exchange for a Congressional failure to act.

In one sense, we are studying the Brady Report too soon, for we do not yet know what, if anything, will eventually come of it. In another sense, however, our studies have come too late—the very fact that the Report was compiled and publicized means that it has already had an impact. Given the inane nature of the Report itself when viewed as a public-interest document, along with its blatant socially harmful intent if viewed otherwise, it seems doubtful that the impact has been a desirable one.