



**Shadow Financial
Regulatory Committee**

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Statement of the Shadow Financial Regulatory Committee
on
Studies of the Stock Market Crash
February 8, 1988

It is now a little over three months since the October 19 stock market crash, but already we have had at least six studies of what happened. A common feature of all of these studies is their confirmation that fundamental economic factors played an important role in the market crash. None suggests that the fall in stock prices was primarily the result of some breakdown in market making or institutional factors.

Nevertheless, many of the studies identify "problems" and propose provocative policy responses. In reviewing these studies, the committee is struck by the failure to establish a relationship between the facts reviewed and discussed and the policy recommendations in the studies. None of the studies suggests that what happened on October 19 would have been any different had any of their policy proposals been in effect in October.

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The committee too doubts that the adoption of these proposals would have made a difference. We are concerned that the studies have become vehicles for everybody's favorite recommendations. In our view, all the studies fail to show how their policy proposals are responsive to the problems or failures that they purport to identify, how their recommendations would have eliminated those problems identified, and whether had the problems not occurred on October 19 the precipitous drop in stock prices would have been affected. Until this is done, little, if any, credence should be given to the recommendations.

The widespread recommendation to impose higher margin requirements on futures transactions illustrates these points well. Were there defaults in October that would not have occurred had there been higher margins? Did stock prices prior to October 19 rise to higher levels than would have occurred with higher margins? Did the stock market fall faster and further than it would have had with higher futures margins? Would price volatility in either the stock or futures market have been lower with higher margins? The committee believes that none of these questions can be answered in the affirmative. In addition, we know of no research, theory, or evidence that suggests that higher margins would have been helpful in October.

While the studies of the crash have served us well in identifying and pulling together information about the events which surrounded the crash, they are not serving us well if they are used to rush to judgment about what, if anything, needs to be done. We urge that no action be taken until more thought will be given to the connection between the policy proposals advanced and what happened in October.

It is the Committee's policy that members abstain from voting on policy statements in instances in which they have a direct personal or professional involvement in the matter that is the subject of the statement. Accordingly, Mr. Hawke abstained from participating in or voting on this statement.