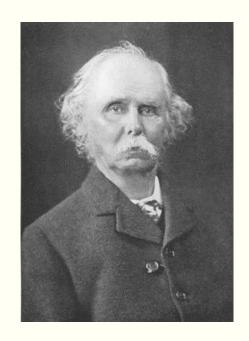
# ALFRED MARSHALL ON SPECULATION: INSTITUTIONS AND ECONOMIC WELFARE

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### An Epigraph

- The motto of the speculator is "do unto others as they would wish to do to you, only do it first".
  - Alfred Marshall

### **Overview of Paper**

- I. Background & Existing Literature:
  - Speculation & HET
  - The Folly of Amateur Speculators
  - Stabilising & Destabilising Speculation
- II. Contribution of Paper:
  - a. Exposits Marshall's microeconomic analysis of speculation
  - b. Establishes a relationship between institutions and economic welfare within Marshall's microeconomic treatment of speculation
    - Identifies a neglected institutional theme in Marshall's analysis of speculation
    - Reconciles the stabilising and destabilising aspects of Marshall's analysis of speculation
- III: Conclusion

### I. Background & Existing Literature: Genuine Economic Importance

- 'The concept of speculation has always fascinated academics and practitioners alike; this may be due to inconsistent definitions, occasional misunderstanding and genuine economic importance.'
  - Jean Tirole (New Palgrave Dictionary of Money and Finance, 1992)
- 'Hasty attempts to control speculation by simple enactments have invariably proved either futile or mischievous: but this is one of those matters in which the rapidly increasing force of economic studies may be expected to render great service to the world in the course of this century.'
  - Alfred Marshall, Principles of Economics (1890)

### I. Background & Existing Literature: Definition

#### Amplo Sensu Speculation

• An act involving risks associated with 'looking into the future' (Marshall 1919, 252).

#### Lato Sensu Speculation

• 'a commercial venture or undertaking of an enterprising nature, esp. one involving considerable financial risk on the chance of unusual profit' (Oxford English Dictionary [n.d.] 2021).

#### Stricto Sensu Speculation

- '[t]he action or practice of buying and selling goods, land, stocks and shares, etc., in order to profit by the rise or fall in the market value, as distinct from regular trading or investment' Oxford English Dictionary [n.d.] 2021).
- NB: Emphasis is placed on *stricto sensu* speculation in accordance with contemporary microeconomic usage, although *lato sensu* and *amplo sensu* speculation are also considered.

# I. Background & Existing Literature: The Folly of Amateur Speculators ([n.d.] 1992)

- Marshall, A. ([n.d.] 1992). 'The Folly of Amateur Speculators Makes the Fortunes of Professionals. The Wiles of Some Professionals'.
- Dardi, M., and M. Gallegati. (1992). 'Alfred Marshall on Speculation.' HOPE.
  - Marshall shifted from a "traditional view," in which speculation is 'an essentially marginal phenomenon', to a "modern view", in which speculation is 'at the very center of the capitalistic engine'.
- Bateman, B. W. (2006). 'Speculation.' ECAM.
  - The 'interesting question that has arisen in recent years is whether Marshall's acknowledgement of the existence of speculation amounted to an understanding that his analytical model of a market-based, capitalist economy had been undercut'.

# I. Background & Existing Literature: Stabilising & Destabilising Speculation

- Paesani, P., and A. Rosselli. (2021). 'How Speculation Became Respectable: Early Theories on Financial and Commodity Markets.' EJHET.
- Paesani, P., and A. Rosselli. (2020). 'Destabilizing Speculation on Organized Markets: Early Perspectives in the Spirit of Marshall.' Marshall and the Marshallian Heritage: Essays in Honour of Tiziano Raffaelli.
  - '[Economic] decisions, and the equilibrium they lead to, reflect complex interactions between different groups of agents operating within an evolving economic and social environment'.
- Two main limitations of current literature:
  - Disconnect remains between the stabilising and destabilising aspects in the interpretations of Marshall on speculation.
  - Marshall's analysis of speculation across his works have not been reconciled

# II. Contribution: Exposition Pigou's Review of Marshall's I&T (1919)

#### MARSHALL'S "INDUSTRY AND TRADE"

Industry and Trade. By Alfred Marshall. (Macmillan and Co. Pp. xxiv+875.)

The next three chapters (V., VI., and VII.) deal with speculation and marketing. Speculation is analysed into three varieties: mere gambling, shrewd business ventures whose gains must be balanced by equivalent losses to other traders, and "constructive" speculation that tends to improve the general application of efforts to the attainment of desirable ends (p. 252). This last does good service by so distributing inherent business risks that they fall increasingly on the shoulders best fitted to bear them. The social utility of the power to sell futures, when employed by able and honest men, is brought out by an instructive reference to the land boom of 1887-90 in Melbourne (p. 265). At the same time, of course, the abuses, to which this and other forms of speculation are liable, are fully recognised. The second of the

### II. Contribution: Exposition Speculation & Economic Welfare

- Constructive Speculation
  - Resource Allocation
  - Capital Allocation
  - Uncertainty-Bearing
  - Liquidity
- Malignant Speculation
  - The Folly of Amateurs
  - The Wiles of Some Professionals

### II. Contribution: Exposition Professionals & Amateurs

- Turn of the century theories of speculation largely focused on issues associated with the interaction between professional and amateur speculators.
- Marshall drew a fundamental distinction between "professional" and "amateur" speculators.
  - "The Folly of Amateur Speculators Makes the Fortunes of Professionals. The Wiles of Some Professionals" (Marshall [n.d.] 1992).
  - While the ideas in "the folly" were not published until 1919, note what Keynes called the "oral tradition" at Cambridge

# II. Contribution: Exposition Malignant Speculation

- The Folly of Amateurs
  - Increase the variability of prices for two reasons:
    - Incorrectly believe to be acting on the most recent news
    - Apt to attribute too great importance to passing changes
      - Cf. Behavioural finance explanation for excessive trading
- The Wiles of Some Professionals
  - May profit merely by anticipating the errors that will be made by amateurs
    - 'shrewd, far-seeing speculators sometimes govern their action, not so much by forecasts of the distant future, as by forecasts of the inaccuracy of forecasts of that future' (Marshall 1923: 96; italics added).
  - May engage in manipulative practices designed further to exploit the folly of amateur speculators.

# II. Contribution: Institutions & Economic Welfare A Neglected (Institutional) Theme

- Douglas North's (1991; JEP) well-known definition of institutions:
  - Institutions are humanly devised constraints that structure political, economic and social interaction. They consist of both **informal constraints** (sanctions, taboos, customs, traditions, and codes of conduct) and **formal rules** (constitutions, laws, property rights)' (North 1991: 97).
- Institutional Aspects of Marshall's Treatment of Speculation
  - cf. Rosenberg, N. (1960). 'Some Institutional Aspects of the Wealth of Nations.' *IPE*.
    - 'A neglected theme running through virtually all of the Wealth of Nations is Smith's attempt to define, in very specific terms, the details of the institutional structure which will best harmonize the individual's pursuit of his selfish interests with the broader interests of society'

# II. Contribution: Institutions & Economic Welfare Schema of Marshall's Theory of Speculation

TABLE 1: SCHEMA OF MARSHALL'S THEORY OF SPECULATION					
A. Concept of	B. Speculation & Economic Welfare				
Speculation	Constr	ructive Speculation	Mali	gnant Speculation	
<ul><li> Amplo sensu</li><li> Lato sensu</li><li> Stricto sensu</li></ul>	<ul><li>Resource allocation</li><li>Capital allocation</li><li>Risk-bearing</li><li>Liquidity</li></ul>		• T	<ul><li>Folly of Amateurs</li><li>The Wiles of Some Professionals</li></ul>	
C. Speculation & Institutions					
Organisation of Markets		Formal Rules		Informal	
				Constraints	
<ul> <li>Historical Development of Organised Markets</li> <li>Comparison of Stock Exchanges</li> </ul>		<ul><li>Access to Markets</li><li>Access to Information</li></ul>		Public Opinion Tendency to Speculation	

# II. Contribution: Institutions & Economic Welfare A Neglected (Institutional) Theme

- Organisation of Markets
  - "highly organized markets"
  - Marshall's 'important additional factor of production' (Groenewegen)

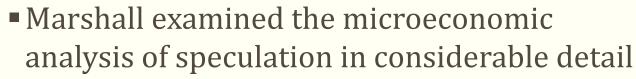
#### ■ Formal Rules

- Access to markets
  - Professionals vs amateurs (did not advocate for restrictions á la Walras)
- Access to information
  - Proposed forecasts 'of trade storm and of trade weather generally'.
    - cf. Keynes's business "barometers" in the Reconstruction Supplements.

#### Informal Constraints

- Public Opinion
  - "Economic chivalry"
- Tendency to Speculation
  - cf. "gambling spirit"
  - May vary across different countries (cf. Keynes)

#### III. Conclusion



 This was carried out within his broader welfare approach to economics

 Marshall's treatment of speculation contained an important institutional dimension

 The welfare consequences of speculation depended crucially upon the institutional arrangements of markets

#### "It's all in A. Smith"

- Identifies a neglected institutional theme in Marshall's analysis of speculation
- Reconciles the stabilising and destabilising aspects of Marshall's analysis of speculation

