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# Populists versus theorists: Futures markets and the volatility of prices ☆

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**Abstract**

In this paper, the divergence between popular and professional opinion on speculation in general and futures markets in particular is explored. Along the way, a synopsis of prevailing popular attitudes on futures markets is presented, and an outline of a formal model of futures markets and its implications for commodity price volatility are sketched. The heart of the analysis is drawn from the historical record on the establishment and prohibition of futures markets. Briefly, the results presented in this paper strongly suggest that futures markets were associated with—and most likely caused—lower commodity price volatility. The paper concludes with a discussion of potential sources of popular antagonism against futures markets.
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*Keywords:* Futures markets; Commodity markets; Commodity price volatility; Speculation

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"For as long as we fail to treat speculators the way they deserve—with a bullet in the head—we will not get anywhere at all."
Vladimir Lenin[1]

"For my part, I wish every one of them [speculators] had his devilish head shot off."
Abraham Lincoln[2]

## 1. Introduction

Religious and social sentiments have generally aligned themselves strongly against the role of speculators, middlemen, and traders.[3] Only in relatively recent times has some of this stigma begun to wear off, yet popular resentment of such agents remains undeniably widespread. Of course, these same actors are celebrated in the lore of the economics profession. Smith, Walras, Keynes, and countless others have reserved a crucial role for them in the smooth functioning of capitalism. Broadly then, what this paper attempts to address is the role of the speculator in the market. Specifically, the relationship between futures markets, speculation, and commodity price volatility is explored. This particular example is undoubtedly salient: in few other areas do popular views and those of most economists more widely diverge.

The fundamental result of this paper is that futures markets are systematically associated with lower levels of commodity price volatility. The means for arriving at this result is a series of quasi-experiments with futures markets provided by history, namely their establishment as well as prohibition through time. In what follows, the paper provides a brief overview of popular perceptions on the issue of prices and futures markets, specifically in the context of the agrarian movement of the late nineteenth century United States. A model of markets with both storage and futures markets is presented and numerically analyzed. Next, the historical behavior of commodity price volatility is examined. The paper concludes with a brief discussion of the sources of popular antagonism against futures markets.

## 2. Prices and futures markets

Even before the rise of organized commodity exchanges, popular sentiment has, at best, been openly suspicious, but generally, openly hostile to the person of the speculator. Coming in between the producer and ultimate consumer, the role of the speculator—carrying with it sufficient price margins—has always been judged by physiocratic standards: productive of nothing, deserving of nothing. As Abba Lerner explains it, "the extraordinary usefulness of speculation...goes ill with the hostility which people who have to work for their living often develop against the mysterious gains that speculators make in offices while dealing in goods which they would not even recognize" (Lerner, 1944, p. 94).

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[1] Lenin (1964, p. 311).

[2] Quoted in Carpenter (1866, p. 84).

[3] For a representative—but by no means exhaustive—sample, cf. Aquinas (1988, p. 98), Aristotle (1988, p. 15), Luther (1955, p. 245), and Wasail al Shi'ah (p. 266).

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