Theme and Variation: Alfred Marshall on Speculation*

Bradley W. Bateman

Grinnell College

Bateman, Bradley W., "Theme and Variation: Alfred Marshall on Speculation" *Marshall Studies Bulletin* 6 (1996): 5-15 <URL: http://www.cce.unifi.it/rivista/bateman6.htm>

references

In their editorial introduction to Alfred Marshall's previously unpublished notes, "The Folly of Amateur Speculators Makes the Fortunes of Professionals. The Wiles of Some Professionals", Marco Dardi and Mauro Gallegati have constructed a novel argument regarding the roles of uncertainty and speculation in Marshall's work. They argue that sometime near the turn of the century Marshall changed from "a typically nineteenth-century vision of speculation as a picturesque and sometimes objectionable, but essentially marginal phenomenon, to a modern view which places speculation at the very center of the capitalist engine" (1). They go on to argue that this shift served both to undercut his theory of price in the *Principles* and to foreshadow the work of J. M. Keynes.

But while these notes are clearly an important archival find, it is possible to see their importance in a quite different light then the one cast by Dardi's and Gallegati's interpretation. Whereas Dardi and Gallegati see the notes as indicating a break in Marshall's thinking, it is at least as plausible to see them as representing a clear continuity in his work (2). And if this is the case, then the roles of speculation and uncertainty in his own work, and in relation to Keynes's, is probably much different than Dardi and Gallegati suggest.

In offering an alternative interpretation of Marshall's text, I would like to make some concessions to the idea in post-modern thought that suggests that differing interpretations of a text are inevitable and that there may be no objective way to choose between interpretations. I will not go the last mile with the post-modernists, however, for I will insist in making my argument that we sometimes have recourse to *facts* in evaluating alternative interpretations. In particular, I will argue that Dardi's and Gallegati's interpretation rests, in part, upon a *factual error* and that this error greatly diminishes its likelihood.

But while insisting on their error, I would like, as I said, to keep one foot in the post-modernist camp and acknowledge the part(s) of my own argument which is (are) unprovable. In acknowledging the limits to my own argument, I would also like to indicate parts of Dardi's and Gallegati's argument which may well be correct, even though I think them unlikely.

1. Dardi's and Gallegati's error

The error at the center of Dardi's and Gallegati's interpretation is their assertion that Marshall abandoned the "over-trading" theory of the trade cycle sometime after the publication of the *Principles*. For while Dardi and Gallegati are certainly correct that Marshall continued to learn and understand more about the *practice* of speculation over time, it is just as clear that he espoused *exactly the same theory of the trade cycle* in

Money, Credit, and Commerce (1923) as he had in his first book (with Mary Paley Marshall), *Economics of Industry* (1879). His treatment of the cycle in his last book is lifted almost verbatim from his book with his wife, and, in fact, carries the same signature quotation from Lord Overstone which Dardi and Gallegati use to identify the overtrading model.

> Thus the state of trade, to use the famous words of Lord Overstone, "revolves apparently in an established cycle. First we find it in a state of quiescence, – next, improvement, – growing confidence, – prosperity, – excitement, – over-trading, – convulsion, – pressure, – stagnation, – distress, – ending again in quiescence" (3).

Nor should there be any doubt that Marshall continued to hold to his original position in the interim 44 years; three paragraphs which follow this quotation from Overstone in *The Economics of Industry*, and which elaborate the "over-trading" or "confidence" theory of the trade cycle, are reprinted virtually unchanged in all eight editions of the *Principles* printed in Marshall's life time.

> Mill well observed that "What constitutes the means of payment for commodities is simply commodities. Each person's means of paying for the productions of other people consist of those which he himself possesses. All sellers are inevitably, and by the meaning of the word, buyers. Could we suddenly double the productive powers of the country, we should double the supply of commodities in every market; but we should, by the same stroke, double the purchasing power. Everybody would bring a double demand as well as supply; everybody would be able to buy twice as much, because everyone would have twice as much to offer in exchange".
>
> But though men have the power to purchase they may not choose to use it. For when confidence has been shaken by failures, capital cannot be got to start new companies or extend old ones. Projects for new railways meet with no favour, ships lie idle, and there are no orders for new ships. There is scarcely any demand for the work of nawies, and not much for the work of the building and the engine-making trades. In short there is but little occupation in any of the trades which make fixed capital. Those whose skill and capital are specialized in these trades are earning little, and therefore buying little of the produce of other trades. Other trades, finding a poor market for their goods, produce less; they earn less, and therefore they buy less: the diminution of the demand for their wares makes them demand less of other trades. Thus commercial disorganization spreads: the disorganization of one trade throws others out of gear, and they react on it and increase its disorganization.
>
> The chief cause of the evil is a want of confidence. The greater part of it could be removed almost in an instant if confidence could return, touch all industries with her magic wand, and make them continue their production and their demand for the wares of others. If all trades which make goods for direct consumption agreed to work on, and to buy each other's goods as in ordinary times, they would supply one another with the means of earning a moderate rate of profits and of wages. The trades which make fixed capital might have to wait a little longer: but they too would get employment when confidence had revived so far that those who had capital to invest had made up their minds how to invest it. Confidence by growing would cause itself to grow; credit would give increased means of purchase, and thus prices would recover. Those in trade already would make good profits, new companies would be started, old businesses would be extended; and soon there would be a good demand even for the work of those who make fixed capital. There is of course no formal agreement between the different trades to begin again to work full time, and so make a market for each other's wares. But the revival of industry comes about through the gradual and often simultaneous growth of confidence among many various trades; it begins as soon as traders think that prices will not continue to fall: and with a revival of industry prices rise (4).

Thus, with Keynes and Edgeworth, we can be reasonably sure that Marshall's views on the trade cycle and money changed little during his lifetime (5).

But what difference does this make to Dardi's and Gallegati's argument? Is the error decisive in rejecting their interpretation of Marshall? The answer would seem to be *not* that the error *disproves* their argument, only that it makes it much less plausible. For Dardi and Gallegati, the importance of Marshall's alleged abandonment of his earlier position is that speculation is a "marginal phenomenon" in the "over-trading" theory of the cycle; speculation leads to economic disorder, but the disorder is passing and so of no great concern. Getting Marshall to abandon this position allows Dardi and Gallegati to attribute a deeper importance to speculation in Marshall's later writings, to place it "at the very center of the capitalist engine". From this position, they are able to argue that speculation is subversive to Marshall's entire theoretical framework.

2. Theme and Variation

But because all the textual evidence points to an unchanging belief on Marshall's part in the "marginality" of speculation, it seems unlikely that Dardi's and Gallegati's interpretation is correct. But while I judge this unlikelihood to be the result of a factual error on their part, I am also aware that in my own mind, their discontinuity thesis is made even less plausible by an additional *conjecture* on my part: Marshall's relegation of speculative bubbles to the status of "marginal phenomena" was, in all likelihood, merely an application of the new idea of probability which swept through the social sciences in the nineteenth century (6). Like so many of his contemporaries, Marshall was "taming chance" and giving it "the respectability of a Victorian valet" (7). I cannot *prove* that this conjecture is correct, but I think that the textual evidence strongly supports it.

The strongest evidence supporting my intuition is in the chapter which appears in Book I of each edition of the *Principles* which dwells on the meaning of "normal" in economics. The chapter takes different titles in different editions, but it clearly marks Marshall as an adherent of the then prevalent conception of probability: although there is wide variation in any observed (economic) phenomenon, the mean value is the one which we can "expect" to occur and so which serves as the appropriate object of our investigations. "And following our definition of an economic law, we may say that the course of action which may be expected *under certain conditions* from the members of an industrial group is the *normal action* of members of that group relatively to those conditions" (8).

This idea, if not its genesis, is known to all students of Marshall in such concepts as the "representative firm" and "normal price". In fact, the term "normal price" might serve as the locus for my argument that Marshall applied the mean reasoning of the "probability revolution" in his treatment of speculative bubbles as passing phenomena. Marshall explicitly constructs a theory in which the "market period" and the "short-run" are eschewed in favor of the "long-run" period in which "all values are expressed in terms of money of fixed purchasing power" (9). Dardi and Gallegati take this focus on the long run to mark a lack of interest on Marshall's part in treating speculation in the *Principles*, "Speculation, and its relationship to commercial crises and monetary instability, is not taken into account in the *Principles*" (10). The more accurate description would seem to be to say that Marshall explicitly treats speculation in the *Principles*, just as he does everywhere else in his writings, as the cause of short-run perturbations that are of little long-run consequence.

Understanding this (hypothetical) continuity in Marshall's thinking is also helpful in seeing why several other of Dardi's and Gallegati's surmises regarding Marshall's increased understanding of speculation are unlikely to be true. For instance, when they say that the greater knowledge he gained regarding the extent of speculation and the unseemly practices of speculators constitutes an "implicit admission that all this, being part of the normal market game, could lead to the systematic distortion of the relationship between the movement of prices and the evolution of market fundamentals" (11), they are almost certainly wrong. For not only is there no evidence that he had changed his mind regarding the "marginal" function of speculation in the economy, he was, in all probability, committed to a style of reasoning that made it hard for him to see the disorders arising from speculation as anything other than passing, if regrettable, events.

Recognizing Marshall's persistent tendency to see these disorders as perturbations around the mean also helps to identify another error on Dardi's and Gallegati's part: their belief that because Marshall eventually realized that some "legitimate," or "real", businessmen engaged in manipulative speculations, he had, therefore, made an "implicit admission" that speculation could overpower enterprise. Marshall's position regarding the transitory, relatively insignificant nature of speculation is explicit throughout *Industry and Trade* (1919) and *Money, Credit, and Commerce* (1923). In *Industry and Trade*, Marshall confines his analysis to speculation in commodity markets, but repeats many times that whatever the extent of manipulative speculations, the force of "legitimate" speculation far outweighs these bad effects.

> In spite of the abuses connected with them, organized markets for dealing in standardized produce, render many services to businessmen and to the world at large...(12).
>
> It is true that the beneficent work is often marred, and sometimes over-borne, by practices which intensify fluctuations and mislead honest dealers: but, for the present at least, that evil has to be taken with the good (13).

The disproportionate benefit of legitimate speculation is even more clearly pronounced in *Money, Credit, and Commerce* where Marshall focuses his attention on speculation in money and stock markets.

> The purchases of almost any "security", of which considerable quantities are habitually bought and sold on a stock exchange, is generally fortified by the knowledge that the expert and well-informed capitalists regard its price as fairly representing its real value. Therefore, although stock exchange machinations may occasionally set for a time, an unduly high value, or an unduly low value on a particular "security", yet, in the main, the judgment of well-informed, capable men protects the general public from grave errors of judgment in their investments, so long as these are conducted with reasonable caution (14).
>
> The stock exchanges are necessary auxiliaries of modern industry and commerce; and the services which they render to the public probably outweigh many times the evils which they cause to it (15).

Thus, in both types of markets, the effects of speculation are limited and of an impermanent nature. In none of this does speculation seem to overpower enterprise (for long) or to be at the center of the engine of capitalism.

Likewise, it does not seem to be the case that Marshall is shy in these later works to mention the unethical practices undertaken by some speculators, or the fleecing they inflict on the unwitting and uninformed. In *Industry and Trade* he makes the "manipulative" and "evil" nature of some speculators explicit.

> Thus by far the greater part of the transactions are in substance merely wagers to the effect that the price of produce will rise or fall. Of these wagers some are, as we have seen, careful, deliberate business operations, sometimes classed as legitimate speculation: others are the almost random guesses of foolish gamblers; and others again are parts of large manipulative policy, which is in the main evil economically and morally (16).

Marshall even goes so far as to use the title from the notes that Dardi and Gallegati discovered in his description of speculation.

> Dealings in organized markets are liable to abuse by unscrupulous men, aided as they often are by *the folly of ill-informed speculators*: but the power of selling the future command of a thing not yet in possession has important uses (17).

In *Money, Credit, and Commerce* he also mentions the manipulation of the "real" businessmen who are supposed to be above, or immune from, speculative manipulation.

> But the ordinary professional is himself at a like disadvantage relatively to great financiers

> in anticipating those wayward moods of the money market that conform to no rule: for indeed those moods are themselves largely fashioned by the great operators (18).

It is, thus, difficult to find any idea or passage in the previously unpublished notes which is not repeated in Marshall's published work. Dardi and Gallegati protest that "critical evaluations of the functioning of speculative markets are no sooner hinted at than dismissed" in Marshall's later work, but this judgment seems possible only if one overlooks the near total coverage of the material from "The Folly of Amateur Speculators" in *Industry and Trade* and *Money, Credit, and Commerce* and if one also overlooks the fact that (in print) Marshall had always seen speculation as having only a short-run effect and so had no reason to dwell on it.

3. Conclusion

Did Marshall believe that capitalist markets are fundamentally distorted by speculation? Did he abandon the over-trading theory of the business cycle and its treatment of speculation as peripheral? Did he find it difficult, because of his "habit of always laying stress in published works on the most edifying aspects of the economic system", to admit what he knew about speculation? Did he purposefully keep the contents of "The Folly of Amateur Speculators" from publication?

The answer to all of these questions, on the textual evidence, would seem to be, "No" (19). Although he admits that manipulative speculation by "real" businessmen takes place, nowhere does he explicitly say that this leads to a long-term trend of prices away from the levels that would be determined by "market fundamentals". Likewise, his adherence to the over-trading model is clear through 44 years of published work despite his understanding that speculation sometimes took an "evil" form. And there seems to be no idea in the earlier notes which is not treated, eventually, in his published works.

But of all these negative responses there is only one of which we can be *absolutely certain*: Marshall never abandoned the over-trading theory of the trade cycle, at least not in print. That much is indisputable.

So one *could* argue that despite this failure to abandon the over-trading theory, he *should* have done so because he came to see speculation as destabilizing and distorting. Likewise, one can argue that his Victorian sense of propriety kept him from admitting that real businessmen would initiate such permanent maladies. One could even argue that it was this same sense of propriety which kept him from admitting that the over-trading model was obsolete. There is no way to disprove any of these hypotheses.

Nor is there any way to prove them. It seems more probable, however, in the face of his continued public adherence to the overtrading model, and his repeated use of the "normal" probabilistic thinking of nineteenth century social scientists, that he simply never came to see speculation as anything more than a short-run, marginal phenomenon. Seeing Marshall's thoughts on speculation as an explicit precursor of Keynes's, or of our contemporary concerns with speculative instability is, in all probability, an act of retrospective teleology (20). Marshall may have been caught in a style of theorizing that was characteristic of his times, but on the evidence he does not seem to have been aware of (or concerned with) any anomalies or contradictions in his position.

- Back to Homepage
-

Notes

* I wish to thank Tim Alborn, Mauro Boianovsky, Marco Dardi, and John Whitaker for comments on an earlier version of this essay. They bear no responsibility for errors of fact or interpretation.

1. Dardi and Gallegati (1992, p. 572).

2. I call Dardi's and Gallegati's interpretation novel because every secondary work I can find dealing with Marshall's work on the trade cycle credits him with having held to a consistent theory of the cycle throughout his life. See Keynes (1924); Edgeworth (1923); Wolfe (1956); Eshag (1963); Bridel (1987); Bigg (1990).

3. Marshall and Marshall (1879, p. 153); Marshall (1920, p. 710).

4. Marshall (1920, pp. 710-711).

5. Keynes (1924); Edgeworth (1923). The best treatment of Marshall's changing views on money is probably in Eshag (1963, pp. 72-77). These changes, to which both Keynes and Edgeworth refer, are concerned with the desirability of inflation versus deflation and are not, per se, changes in Marshall's theoretical structure.

6. The story of the Probabilistic Revolution in the social sciences is, of course, the topic of one of the most ambitious recent programs in the history of science. See, for instance, Porter (1986); Hacking (1990); Morgan (1990); Gigerenzer et al. (1989); Stigler (1986); Krüger et al. (1987).

7. Hacking (1990, p. 2). As the long passage cited above suggests, Marshall may well have been mimicking J. S. Mill in his construction of "l'économie moyen". S. Hollander (1985, pp. 483-519) has explained nicely the way that Mill resolved his argument for short-run fluctuations with his belief that Say's Law holds in the long-run. Hollander does not connect this facet of Mill's work with his theory of probability, but Mill was, of course, an adherent of the "objective" theory of probability which characterized the Probabilistic Revolution. For Mill on probability, see Porter (1986, pp. 82-3).

8. Marshall (1920, p. 34).

9. Ibid., p. 593.

10. Dardi and Gallegati (1992, p. 577).

11. Ibid., p. 578.

12. Marshall (1919, p. 253).

13. Ibid., p. 257.

14. Marshall (1923, p. 91).

15. Ibid., p. 95.

16. Marshall (1919, p. 258).

17. Ibid., p. 262, italics added. This is actually the heading for a section of a chapter, on the next page (p. 263), Marshall refers to "the folly of amateur investors".

18. Marshall (1923, p. 259).

19. John Whitaker has suggested an intermediate position. Marshall may have come to realize that speculation caused problems for capitalism, but not been up to the creative effort necessary to develop this insight. This may well be the case. But in any case, the textual record shows no concern that is not fully considered in his published work.

20. The term "retrospective teleology" is from Collini, Winch and Burrow (1983).

REFERENCES

Bigg R. (1990), *Cambridge and the Monetary Theory of Production*, London: Macmillan.

Bridel P. (1987), *Cambridge Monetary Thought*, London: Macmillan.

Collini S., Winch D. and Burrow J. (1983), *That Noble Science of Politics: A Study in Nineteenth-Century Intellectual History*, Cambridge: Cambridge University Press.

Dardi M. and Gallegati M. (1992), "Alfred Marshall on Speculation", *History of Political Economy*, 24:3, Fall, pp. 571-594.

Edgeworth F.Y. (1923), "Review of *Money, Credit and Commerce* by Alfred Marshall", *Economic Journal*, 33, pp. 198-204.

Eshag E. (1963), *From Marshall to Keynes: An Essay on the Monetary Theory of the Cambridge School*, Oxford: Basil Blackwell.

Gigerenzer G. *et al.* (1989), *The Empire of Chance: How Probability Changed Science and Everyday Life*, Cambridge: Cambridge University Press.

Hacking I. (1990), *The Taming of Chance*, Cambridge: Cambrdige University Press.

Keynes J.M. (1924), "Alfred Marshall, 1842-1924", *Economic Journal*, 24, pp. 311-372.

Krüger L. *et al.* (1987), *The Probabilistic Revolution*, 2 vols, Cambridge: MIT Press.

Marshall A. (1919), *Industry and Trade*, London: Macmillan.

_______ (1920), *Principles of Economics*, 8th ed., London: Macmillan.

_______ (1923), *Money, Credit and Commerce*, London: Macmillan.

_______ (n.d.), "The Folly of Amateur Speculators Makes the Fortune of Professionals. The Wiles of Some Professionals", reprinted as an appendix to Dardi and Gallegati (1992).

Marshall Paley M. and Marshall A. (1879), *Economics of Industry*, London: Macmillan.

Morgan M.S. (1990), *The History of Econometric Ideas*, Cambridge: Cambridge University Press.

Porter T.M. (1986), *The Rise of Statistical Thinking, 1820-1900*, Princeton: Princeton University Press.

Stigler S.M. (1986), *The History of Statistics: The Measurement of Uncertainty before 1900*, Cambridge: Harvard University Press.

Wolfe J. N. (1956), "Marshall and the Trade Cycle", *Oxford Economic Papers*, 8, pp. 90- 101.