Thy Brother's Keeper?

True or False: A commodity trader is someone who, upon seeing a bleeding victim by the side of the road, kicks him and takes his wallet? We have all heard the witticisms: when they pass around the cookies, take a few; it is immoral to let a sucker keep his money; and so on.

Perhaps these attitudes are a natural outgrowth of the zero-sum world traders live in; if your gain is my loss, then why should I have any sympathy for you when the situation is reversed? This is all quite harmless in the broader scheme of things. But what happens when there are innocent bystanders affected by traders' actions? Do we traders as a class have a greater obligation to our fellow man?

These questions were raised, albeit in a self-serving way, by Malaysian Prime Minister Mahathir Bin Mohamad when the Thai baht, Indonesian rupiah, Malaysian ringgit, Philippine peso and their associated equity markets all collapsed this year. Dr. Mohamad went so far as to accuse (wrongly, as far as anyone can determine) George Soros by name and called currency traders "morons," an appellation more normally associated with bond traders.

Dr. Mohamad has raised several serious points and has made some indisputable observations. First, currency trading has somehow become the world's largest business, with transactions on the order of twenty times the underlying goods and services. Second, currency fluctuations cause significant frictional costs in the global economy as relative costs of production and competitive advantages swing therewith. Third, no currency is immune to speculative runs – one only need to consider the path of the yen-dollar exchange rate over the past four years from 125 to 80 and back toward 120.

However, as they say in Chancery courts, those who seek equity must come with clean hands. Malaysia's central bank, Bank Negara, was a renowned speculative currency trader on the nation's account for much of the late 1980s and early 1990s. Unlike a private trader, who risks his own capital and/or career, central bank traders are playing with taxpayer money and are often immune from the consequences of their actions. If, as Dr. Mohamad has stated, "These manipulators have no conscience," then what can we say of the European central banks who squandered an estimated $60 billion of their taxpayers' funds for no apparent gain in the September 1992 chapter of the ongoing European currency saga? Was it proper for the Exchequer to raise interest rates in the U.K. to unsustainable levels, quashing his own peoples' hopes and dreams, in order to fulfill some arbitrary cross-rate against the Deutsche mark? For that matter, who asked the Clinton administration to orchestrate a lower dollar with respect to the yen in the 1993-1995 period while the Japanese were struggling to recover from their excesses of the 1980s?

Paul Krugman of the Massachusetts Institute of Technology warned several years ago South Asian growth rates were unsustainable since they depended more upon continued application of cheap labor than efficient use of capital and technology; his warnings were most unwelcome throughout the region. This did not stop a real estate binge that would have done Houston, circa 1982, proud. Thai banks abandoned judgment en masse, while Malaysia built not only the world's tallest buildings, a concept most people understand, but also embarked upon construction of the world's longest building, a true sign of confusing brains with a bull market. Entries in the Guiness Book are not a sound basis for national policy.

The notion that "speculators" are destabilizing vermin is a permanent feature of the human psyche; it is found both across cultures and down through time. Nobody likes the guy running the black market even as they line up to buy from what is likely to be the only source of supply in town. This writer once had the pleasure of sitting next to a lawyer while on a plane trip to Houston in 1981. The stout barrister opined that traders and traders alone were responsible for the huge increase in oil prices. How so? "Every time you guys buy, you only sell it at a higher price!"

Since the dawn of time, market squeezes have had an unhappy ending for the squeezor: the persistent buying of someone that is only worth $1.00 for $1.20 followed by $1.25 is not a winning strategy for long. If George Soros or others of his ilk were actually selling the ringgit or the baht for a price well below value, they would have gotten their just and due desserts just as the Hunt brothers got theirs for pushing the price of silver up to $50 per ounce.

If the South Asian currencies were pushed, even temporarily, below their intrinsic value -- whatever that may be -- for manipulative purposes, then Dr. Mohamad would be correct in denouncing these traders as international bullies who hurt many defenseless individuals and firms so they could capture short-term profit. Our markets adopted restrictions against such deliberately destructive trading years ago, and while more devout free-market colleagues might dissent, these restrictions are akin to not shouting “fire!” in a crowded theater.

There is no evidence that any of the selling of the currencies was premeditated or done in deliberate concert, however. A more likely explanation is simple crowd behavior, the same simultaneous rush for the exits that characterizes so many market manias and panics. The establishment of some sort of coercive international market policing agency to prevent such price swings would have a devastating side effect: if investors believed that their ability to sell freely upon demand were to be limited, then they would either not invest at all, or would have an even-quicker finger on the panic button at the first whiff of trouble. Neither would do much for the flow of investment capital into South Asia.

The real social role of the speculator is far more akin to the little boy who noticed that the Emperor had no clothes. Currency traders did not produce the overvaluation of the ringgit or the baht in 1997 any more that they produced the overvaluation of the Mexican peso in 1994 or the Japanese yen in 1995. Speculators simply ratified underlying economic conditions. When they had the opportunity to exchange the overvalued currencies for those whose assets could produce a better return, they simply did so. Global markets are under no obligation to maintain an overvalued ringgit for the benefit of Malaysian dollar debtors. The welfare of the Malaysian people is primarily the responsibility of – the Malaysian people. For traders to perpetuate the charade of overvaluation of a single currency or group of currencies means that their capital will not be deployed to better use elsewhere, and these economies will suffer in turn.

We should conclude, therefore, that while traders do in fact have a social duty not to act in a deliberately destructive manner, they have no other duty beyond their derivative benefit of facilitating the efficient use of the world’s resources. The obligations to construct and maintain sound national policies lie elsewhere. If world markets hold a mirror up to the architects of these policies, and angry outbursts ensue, then we all have learned something.