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EMPIRICAL INSIGHT AND SOME THOUGHTS ON FUTURE(S) INVESTIGATION

Comments on Mark West's 'Private Ordering at the World's First Futures Exchange'

*A.W. Brian Simpson**

Some considerable number of years ago, when I was in Chicago, I had a plan to undertake a general study of the origins of futures markets. They fascinated me for a variety of reasons, one being their bizarre nature: traders meeting together, usually in some form of ring, in order to sell, on a huge scale, quantities of commodities which they neither possess, nor intend to possess, to other traders, who have not the least wish to receive such commodities, and nowhere to put them if they did. At first sight it appears a weird perversion of the institution of the contract of sale. So I wondered: How did such markets ever come into existence? In any event, I did some work on the records of the Chicago Exchange and on the Liverpool cotton market. Though I published a piece on the latter, the general study was never completed.[1] This explains why I was especially interested in two of the articles in this symposium, one by Lisa Bernstein and the other by my colleague, Mark West. I shall confine my comments to Mark West's article.

We are not here talking about markets in the modern economists' abstract sense of the term, but in an earlier, more concrete sense — as a place, not a concept. It is a place where people come together in order to trade with each other. Such markets, by their very existence, facilitate trade by reducing the costs of transactions. They are commonly associated with institutional arrangements that contribute to this end. For example, markets need to be reasonably safe places; they need to have a fixed and predictable location, and be held at known times, so that those who want to trade know where to come and when. Many markets of this kind still exist in the world, and I regularly attend one in Ann Arbor: the Kerrytown Farmers' Market. There are numerous studies of their history, for example in some of the volumes produced by the English Selden Society. Some such mar-

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1. *See* A.W.B. Simpson, *The Origins of Futures Trading in the Liverpool Cotton Market*, *in* ESSAYS FOR PATRICK ATIYAH 179 (Peter Cane & Jane Stapleton eds., 1991).

kets may provide facilities for the sale of a wide range of commodities and products; some evolve to cater only for trading in a single commodity, such as wheat or cotton. It may be possible to explain why such specialized markets come into existence and why they come to be located in particular places.

Futures markets are an offshoot from specialized commodities markets, where only a single commodity is traded. In futures markets, the rules and customary practices that impose order in the market have been adapted, originally by a process of distortion, so as to facilitate trading not in the commodity itself, wheat or cotton, but in *contracts* for wheat or cotton. Contracts have themselves been commodified. At the time I was doing some empirical work on the subject, there was a general consensus in the literature that futures markets first appeared at some point in the nineteenth century, either in Europe or in the United States. Mark West's article on the Dojima Rice Exchange shows clearly that this assumption was quite wrong — an active futures market existed in Japan two centuries earlier. A recently published popular book, *Tulipo Mania*, provides evidence that futures markets in contracts for tulips also existed in the Netherlands in the seventeenth century.[2] I have not studied the sources on which this book relies and therefore am not clear as to precisely how these markets operated, or whether they ought to be regarded as futures markets. But if so, we see the interesting phenomenon of very similar institutions evolving at much the same time in wholly different social and legal contexts.

There are numerous questions posed by futures markets, and there is, of course, a large theoretical literature, mainly written by economists, which examines modern markets of this type and their operation. Empirically based historical studies of particular futures markets are less evident in the literature, and therefore, Mark West's article is an important contribution. It encourages me to raise some theoretical questions of an analytical, rather than an explanatory, nature. They are questions to which I do not claim any clear answers, but which seem to me of importance relative to the history of such markets.

First of all, what is a futures market? What are its essential features? Are such markets to be defined in terms of their economic function or in terms of the contractual techniques through which they operate? For example, option trading and futures trading seem to serve the same function, but, puzzlingly, serve it through different legal forms. It is plain that futures trading evolves out of the practice of making forward delivery contracts for commodities, and that developed futures markets are organized to facilitate short selling, which

2. MIKE DASH, TULIPO MANIA: THE STORY OF THE WORLD'S MOST COVETED FLOWER AND THE EXTRAORDINARY PASSIONS IT AROUSED (1999) (discussing, especially in Chapter 10, the tulip market in the Netherlands).

becomes the regular practice and is quite central to the operation. In the piece I wrote on the Liverpool Exchange, I tried to explain the process of evolution and relate it to the contractual forms that were used and the technological changes that generated new contractual forms. In attempting to do this, I faced two difficulties. One was definitional: What is to count as a futures market, as contrasted with a forward delivery market? Can a clear line be drawn between them? There would probably be a broad measure of agreement on the typical characteristics of fully developed modern futures markets. But a historical enquiry attempts to explain the process whereby such markets come into existence in the first place, for there once was a time when no such markets existed. Historical enquiry concentrates attention on transitional forms — giraffes, as it were, with only fairly long necks, but getting there. This generates a second difficulty, related to the definitional issue: What are the characteristics which should be regarded as critical to the transition? Only detailed empirical work can shed any light on this, and show how the process of evolution takes place, and why. There are inevitably problems that impede understanding of the process. Some derive from a lack of satisfactory evidence, whilst others may be of a purely analytical character. In relation to the Osaka market, for example, when and how did the receipts for rice come to take on a fictitious character? It may be, as I found with the Liverpool cotton market, that the surviving evidence is not always able to provide answers to such questions.

Secondly, why do futures markets develop in relation to some products, but not in relation to others? Is it something to do with the fact that some commodities — rice and grain, for example — can be stored in large quantities without deterioration? Is it connected with the technology of storage? Grain storage in silos perhaps facilitates the evolution of the fictitious receipt; so long as grain is being put in at the top and coming out at the bottom, it does not matter if the quantity in the silo actually corresponds with the quantity for which receipts have been issued. Is it connected with ease of grading? Rice is perhaps easy to grade, whereas tea, for which futures trading has never evolved, is very difficult. Cotton, however, is also very hard to grade objectively; yet futures trading in cotton still evolved. Has it got something to do with seasonal variations in supply? And why do some futures markets exist for a while, and then fade away? I have been told there once operated for a short period a futures market in eggs, but no such market currently exists. Given that economists can provide general explanations of the *economic* function of futures markets, there may be other *non-economic* factors that explain why this mechanism has been limited to certain commodities.

A third general question arises in the following way: Since unresolved disputes between traders are disruptive, and therefore an impediment to trade, have markets often — perhaps always — been associated with expeditious arrangements for settling disputes? Intimately associated with them has been the development of bodies of rules and customary practices that produce order in the market and provide standards of acceptable and unacceptable conduct by traders. Without them, and other social constraints on behaviour not peculiar to the market, trading could not be conducted. These bodies of rules and customs can become very elaborate and resemble legal systems in miniature.

Mark West's article addresses and casts valuable light on one such miniature legal system at the Osaka market. In doing so, it makes use of the contrast between formal and informal legal systems, or, if you like, between public and private ordering of markets. The legal academy has recently rediscovered the importance of what have come to be called "social norms" or "private ordering" somewhat in the spirit of reinventing the wheel. There are various analytical and explanatory questions about the distinction between public and private ordering that still lack satisfactory answers. In medieval England where the common law system was invented, there existed multifarious local bodies of customary law: in cities, in guilds, in manors, in ports, in markets, and in particular trades, such as that of hard-rock mining. There were also bodies of law that were personal, as for example the law relating to clerics. Eventually one normative body, the common law, became privileged as the basic legal system, and all other bodies of law were either exiled entirely as wholly illegitimate, or relegated to a subordinate status, legitimated on the theory they existed by leave and license of the common law. I wonder how this all worked in Japan in the seventeenth century. Was the Osaka rice market unique? Presumably there must have been other markets, for example a market in fish. How did they operate? How did their arrangements fit into the legal scheme of things? It would be interesting to know whether there exists evidence that would shed some light on this question.

Oliver Wendell Holmes in "The Path of the Law" said: "We have too little theory in the law rather than too much . . . ."[3] I am sometimes inclined to think that in the world of academic law, we run the risk of having too much theory chasing too small a body of empirical information. The papers at this conference have effectively combined empirical enquiry with theoretical analysis. Mark West's article is a good example of how it can be done.

3. OLIVER WENDELL HOLMES, JR., *The Path of the Law*, *in* THE ESSENTIAL HOLMES: SELECTIONS FROM THE LETTERS, SPEECHES, JUDICIAL OPINIONS, AND OTHER WRITINGS OF OLIVER WENDELL HOLMES, JR. 160, 175 (Richard A. Posner ed., 1992).