

BOOK REVIEW

Emily Lambert, *The Futures: The Rise of the Speculator and the Origins of the World's Biggest Markets*. New York: Basic Books, 2011, 240 pp., ISBN: 13: 978-0465018437, \$26.95.

Emily Lambert's book, *The Futures: The Rise of the Speculator and the Origins of the World's Biggest Markets*, tells the story of futures trading in Chicago, from the founding of the Chicago Board of Trade (CBOT) in 1848 to the merger of the CBOT and the Chicago Mercantile Exchange in 2007. Lambert, a Forbes columnist, tells the story through the personal histories of traders whose fortunes shaped the Chicago markets.

The book is divided into three sections, proceeding roughly chronologically. The first devotes six chapters to trading in agricultural futures. The second is devoted to financial futures. The third treats a hard-to-coral herd of contracts and topics: oil futures, foreign exchange, computerized trading, and carbon credits. The book most coherently and engagingly describes the earlier periods, in the first two sections. The more recent history, including the rise of electronic and high-frequency trading, is less satisfying and complete—not surprising given the contemporary nature of the topics.

For students of markets, *The Futures* is a fascinating read—one that challenges the view that where gains from trade are positive, markets will automatically arise. The story Lambert tells is heavily influenced by serendipity. Why did trading begin in onions? Because exchange members had time on their hands during seasonal lulls in egg trading. Why did the CBOT branch into the trading of stock options? Because price supports stabilized grain prices in the 1960s, leaving wheat traders with little action. There is no economic determinism here—just the happenstances of individual entrepreneurs.

Many of the traders' stories make for good yarns, for example, that of the wildly successful corner on wheat by Benjamin Hutchinson in 1888 and his unsuccessful attempt to corner the corn market three years later. Lambert gives cultural life to financial history by retelling the old saw about the ethnic makeup of competing markets. If your last name was Murray, you belonged on the Irish-dominated CBOT. If your first name was Murray, you belonged on the Jewish-influenced Merc.

Futures markets are, to many, the iconic marketplace—competitive, anonymous, and efficient. But they also conjure up images of greed and manipulation. Lambert doesn't attempt to understand the social benefits and costs of futures trading—and that is perhaps more the job of economists than historians and journalists. But an economist reading the book will look for the market failures, or information-generating opportunities, that motivated the creation of new contracts and markets. The nature of those opportunities is often hard to discern.

The book is a history of entrepreneurs trying to make money by trading and by creating new trading institutions. Although economists are part of the story and their personalities enter in (Milton Friedman, Merton Miller, Paul Samuelson, and Richard Sandor all make appearances), the book is about lives, not markets or theories. Still, the history gives flesh to the bones of what little theory there is on the evolution of markets. Reading *The Futures* reminds one of the theories developed by Lester Telser.

In a 1981 article in the *Journal of Law and Economics*, Telser tells a story of how futures markets came to be. It begins with farmers in the Midwest selling their grain in Chicago, a center of population and industry. In Chicago, farmers meet and contract with consumers of grain, such as millers. Contemporaneous exchange of grain for money evolves into agreements in which the miller does not take immediate possession of the grain, for reasons of convenience to the miller and possibly the farmer as well. What is traded is not grain, but claims on grain in storage, or warehouse receipts. Initially, warehouse receipts are claims for wheat owned by a particular farmer, but eventually, warehouse receipts come to be standardized claims to fungible grain in storage. As they become reliable temporary repositories of value, warehouse receipts take on aspects of currency.

Further, forward contracts are entered into: Farmer Brown sells to Miller Jones for future delivery. Such exchange is strongly conditioned on identity and reputation: because the exchange of grain for money is postponed from the date of contract, each party to the transaction bears the risk of the other's failure to perform. In Lambert's book the CBOT in 1848 focused on the trading of physical grain, but that quickly changed. Contracts for future delivery were first agreed to in 1851. By the mid-1850s, it was common for contracts to be traded several times before the farmer ultimately gave up possession of delivered grain to the contract owner. In the mid-1860s, markets became liquid and contracts became fungible. According to Lambert, "by 1865, the contracts started to look alike" (p. 6).

The rapid changes in the early years of the CBOT represent an evolutionary leap over grain trading prior thereto. The creation of an exchange and clearinghouse constituted traders taking the market private: the CBOT became a party to all transactions. Forward contracts between Brown and Jones became obligations to the exchange and what was like barter became three-party exchange. Jones buys obligations of the exchange for future wheat. The exchange secures its wheat with contracts for future delivery from Brown. Brown and Jones worry only about the creditworthiness of the exchange, not that of each other, and the exchange emerges as the least-cost enforcer of contracts and bearer of default risk. What has evolved in this crucial step is trading in which identity doesn't matter—or matters little. In Telser's words, the exchange "facilitates trade among strangers." (The importance of trade among strangers has recently been emphasized by Matt Ridley in his book, *The Rational Optimist*. To Ridley, trade among strangers is *the* engine of growth; trade not limited by kinship or location, but among strangers.)

The Futures replays the history of futures trading in parallel to Telser's theory, but as a sequence of private made-from-scratch markets. As Lambert tells it, the CBOT trading floor arose naturally from 19th century trade in grain in Chicago and, later, became an engine of innovation. Once established, it provided a low cost way to audition new contracts. New contracts for broiler chickens, lumber, and later financial derivatives were patterned after the existing more venerable grain contracts. As a privately owned trading platform, the CBOT had profit incentives to create successful contracts. Perhaps because the costs of experimentation were low, the failure rate of devised contracts was high.

In the evolutionary, Telserian, view some individual has to innovate and take the risk of institutional failure. This person is the entrepreneur. In highly developed markets, entrepreneur traders arbitrage away price differentials of standardized fungible commodities. They acquire and process information and take financial positions that pay off if the entrepreneur's information and interpretation are correct. In other situations, where exchange is less developed, entrepreneurs form completely new ways of producing, consuming, and exchanging. A few change the world, by inventing means of exchange that eventually are called markets. Lambert tells the story of market evolution through the eyes of just such entrepreneurs.

REFERENCES

- Lambert, E. (2011). *The Futures: The rise of the speculator and the origins of the world's biggest markets*. New York: Basic Books.
- Ridley, M. (2010). *The rational optimist: How prosperity evolves*. New York: Harper Collins.
- Telser, L. (1981). Why there are organized futures markets. *Journal of Law and Economics*, 24(1), 1–22.

Walter N. Thurman

*Wm. Neal Reynolds Distinguished Professor,
Department of Agricultural and Resource Economics
North Carolina State University
Raleigh, NC 27695-8109
E-mail: wally_thurman@ncsu.edu*