

JUSTICE LIMITS ILL-GOTTEN GAINS IN MARKET TRANSACTIONS

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There is a profoundly important difference in the way economic agents function in product and resource markets – the so-called real economy -- and in financial markets. In the real economy, buying and selling is based on the positive-sum premise that every person engaged in a given exchange achieves a gain. Without that gain, exchange collapses. Buying and selling typically take place under conditions of certainty and transparency to help assure that justice is served.

In the financial sector investing, hedging, and speculating are based on the zero-sum premise that one agent’s gain is another’s loss. Investors, hedgers and speculators are driven by the uncertainty and risk associated with future price movements. Hedgers are risk-averse; they avoid risk at the expense of the greater gains possible. Speculators are risk-inclined; they take on risk for the greater gains possible. Investors can be risk-averse, risk-inclined, or both.

In the following we address buying and selling in the real economy and investing, hedging, and speculating in the financial sector in order to better understand how they are alike and how they differ. Our purpose is not to exam these activities to the finest detail but to underscore the difference between positive-sum and zero-sum activities and the role of justice in the real economy and the financial sector.

Our focus is strictly on U.S. economic and financial institutions. Even so, the principles of justice that apply to economic affairs in the United States apply as well in other market economies.

BUYING AND SELLING IN THE REAL ECONOMY

***Economic Gain.* Every exchange entails gain for the persons involved provided they are well-informed and free to act: what is gotten in the exchange (use value) is more highly valued than what is given up (exchange value). To illustrate, a person shopping for shoes comes across a pair priced at \$118 (exchange value). In deciding whether to purchase those shoes that person routinely asks the question “Are they worth \$118 to me (use value)?” If $\text{use value} > \text{exchange value}$, that person purchases the shoes. If $\text{use value} < \text{exchange value}$, he/she turns away.**

Under competitive market conditions, exchange value should not vary from one person to the next. The price paid for the same dog food in a supermarket is the same for everyone buying that brand. However, use value is not the same for everyone who buys that dog food because some persons are more attached to their dogs and derive greater pleasure from feeding and caring for them than do others. While exchange value is determined by market conditions at the time and place of the exchange, use value is determined by the value

systems of the different persons involved in the exchange. Exchange value is an objective piece of information. Use value, on the other hand, is a subjective human experience.

Without that gain, the exchange cannot be carried out. However, without a limit to the extent of that gain and its origins, some persons in the exchange process are able to take more than their due while others are left with less. Conventional economics brushes aside the problem of exploitation and victimization with the invisible hand argument. Every economic agent in the pursuit of his/her own self-interest serves the good of all through the “invisible hand.” Therefore, introducing justice into economic affairs is unnecessary and threatens the value-free nature of conventional economic science.

Personalist economics rejects the invisible hand on grounds that its appeal to magic and rhetoric is no substitute for the call of justice to reason and substance. Personalist economics accepts a value-laden economics as the price for aligning the study of economics more closely with economic reality.

In the workplace, for example, when the baker hires a sales clerk to tend to his/her customers, there is gain for both parties. The baker gets the value that the clerk’s labor services adds to what is produced which is greater than the wages that must be paid, thereby adding to the baker’s profits. Without that gain, the baker could not afford to hire the sales clerk. At the same time, the clerk contributes his/her labor services because the wages paid are more useful, more highly valued, than the time and effort involved in working. Without that gain the clerk would not accept the job.

The gain to the worker or the owner of natural resources that are used in the production process may be enhanced further by the generous employer/producer who pays more than is absolutely required perhaps in the expectation that his/her generosity will be repaid by more diligent workers and more careful suppliers, thereby adding to the employer’s profits. The model employee or supplier is one who contributes more to profits than is normally expected.

In the marketplace, the baker produces more loaves of bread than can be used for his/her own personal consumption, and sells them provided what is gotten (the price paid by the customer) is more useful than what is given up (the cost to produce the bread), thereby adding to the baker’s profits. Without that gain, there is no incentive for the baker to produce and sell bread. At the same time, the baker’s customer who does not bake bread, or does not make it as well or as inexpensively, buys from the baker because the bread that

is gotten is more useful than the money given up. A bargain is an exchange in which the consumer's gain is greater than initially expected.

Gain for the worker and the resource holder originate in a single market – the resource market. Similarly, gain for the consumer originates only in the product market. However, profits flow from two sources because the producer engages in exchange in two markets each yielding its own gain. There is (1) the gain that comes from the producer's buying inputs in the resource market for use in the production process, and (2) the gain that derives from selling the finished goods in the product market. Thus the producer's profits are enhanced in two fundamental ways: by reducing the cost of production and by selling finished products at a higher price.

JUSTICE AND THE NEED FOR LIMITS ON THE AMOUNT OF ECONOMIC GAIN

There must be limits to the amount of gain in order to prevent one party from taking advantage of another and to assure that market exchange serves everyone fairly and effectively and not just those with the power and will to turn gain into excess. Those limits are grounded in the duties that human beings owe one another under the principles of commutative justice, distributive justice, and contributive justice.

Commutative Justice. Commutative justice (also known as the principle of equivalence) states that buyer and seller in the marketplace and worker and employer in the workplace have two duties that are binding on both parties. First, they are to exchange things of equal value. Second, they are to impose equal burdens on one another. In many such transactions, personal experience informs us as to what equal value means. By equal burden we mean that the burden of the seller is to give up possession of the good or service in question. For the buyer, the burden is to give up possession of the money necessary to buy and take possession of that good or service. For the worker, the burden is performing the work required by the employer. For the employer, the burden is paying the worker the agreed wage.

At first glance, exchanging things of equal value implies that there is no gain involved. On closer examination we see that this is not the case. Exchanging things of equal value refers to exchange value, not use value. As we indicated previously, exchange value refers to (a) the price paid to purchase a good or service and (b) the wage or price paid to hire a worker or natural resource to produce that good or service. Use value is what is gotten, that is the usefulness of the good or service or the value added of the resource to the person who acquires it. The two taken together result in economic gain under the following condition:

gain is realized when use value > exchange value.

Whereas use value cannot be influenced by the other party to an exchange, exchange value at times can be determined directly by the other party. In those cases, restraint may be necessary. However, when a market is reasonably competitive, exchange value normally does not fluctuate markedly from day to day and is the same or nearly the same for all buyers on the same day. Competition in other words reduces the control that any single buyer or seller has over price, keeps the market price close to the cost of production, and allows a reasonable but not undue profit margin. Thus there may be little need for personal restraint. Gain under these circumstances can be represented as follows:

gain is justified when use value > exchange value restrained by competition.

A problem arises, however, when the market does not impose this restraint, and agents are free to act, more or less, without restraint. Action of this type can occur when the producer fixes the price through a cartel or when the buyer is simply ill informed about the market price and overvalues the product or service offered for sale. In such cases, the gain of the seller is ill-gotten because it is based on taking advantage of the buyer. Unrestrained action may involve a buyer who has an opportunity to enhance his/her gain when the seller is unaware of the true value of the product or service offered for sale. This could happen, for example, in a flea market where the seller offers a book for sale at a low price unaware that the book is a very valuable first edition, or when a widow offers property for sale which she has grossly and innocently undervalued. Commutative justice in all such cases informs both parties that the only justifiable gain is one that does not deprive the other party of the gain that is rightfully his/hers. The following simplification expresses the nature of the gain that is justified under these conditions:

**gain is justified when use value > exchange value restrained by faithful adherence
to commutative justice in a situation where competition alone
does not provide the necessary restraint.**

Two other examples may be instructive in driving home this argument. First, a market price that is determined entirely by the producer – in the extreme by a monopolist – violates the commutative justice because the margin of profit inflates the price and effectively manipulates exchange value, yielding ill-gotten gain for the monopolist. In this case, the buyer who needs the monopolist's product or service has no option other than to buy from the producer who controls the price. Second, the same problem arises in a labor market when a labor union imposes on the employer wages much higher than the going rate, or wages in excess of the worker's value added. It follows that commutative justice is supported by and indeed justifies government interventionist policies which encourage

competition by, for instance, breaking up firms that dominate a market and which punish noncompetitive practices such as collusive price fixing.

Distributive Justice. Distributive justice defines the duties of the superior to his/her subordinates. Specifically, distributive justice requires the superior to distribute the benefits and burdens of the group under his/her supervision among its members in some generally equal fashion. This does not mean strictly equal because there likely are significant differences among subordinates and it is entirely appropriate to take those differences into account. For example, handicapped employees appropriately may require different parking and restroom accommodations than able-bodied employees. Single parents in general shoulder heavier child care responsibilities than married parents.

Distributive justice demands that the superior differentiate among subordinates only when the differences among them are real and substantial and require different arrangements. A superior may allow a single parent to rush home to tend to a sick child when the same permission might be denied to a married worker with a spouse who routinely stays at home to look after the children.

Discrimination occurs when the superior differentiates among subordinates for reasons that are insubstantial. In this regard, false stereotyping may be the device used to rationalize the difference in treatment among subordinates. For example, older workers may be treated differently because they simply have “less upside potential” than younger workers. Women may be treated differently because for them work is of secondary importance in their lives. Discrimination and the government intervention required to address it are evidence that the law of nature -- each individual economic agent in the pursuit of his/her own self interest also serves the common good through the invisible hand -- is not always sufficient to resolve important conflicts in economic affairs.

Distributive justice limits ill-gotten gain because the fair-minded superior assures that what is gotten and what is given up are the same for everyone in the same or similar circumstances. The ill-gotten gain for the public official who has been bribed to award a contract for a clearly substandard proposal is the money which that official has gotten dishonestly. The ill-gotten gain for the employer who discriminates is the additional profits deriving from denying some workers the pay and benefits their performance merits.

Contributive Justice. Contributive justice defines the obligation of the member to the group to which that person belongs. Insofar as a person receives benefits from the group, that person has a duty to maintain and support the group. Paying dues is the usual requirement

for the persons joining and remaining active in a membership organization. Failure to pay membership dues typically reduces a person to inactive membership status enjoying fewer benefits of membership as compared to those in good standing.

There are several powerful examples of violations of contributive justice in the marketplace and the workplace. In the workplace, industrial spying and sabotage violate contributive justice because the person who appears to be a loyal and productive member of one business establishment actually is faithful to a rival organization and seeks to undermine the effectiveness of the first establishment by stealing secrets and disrupting its work, thereby resulting in an unfair competitive advantage for the rival organization and ill-gotten gain.

Insider trading is the practice of persons within a corporate organization whose shares of stock are publicly traded using information that is confidential and not available to the trading public in order to buy or sell shares in that corporation for personal gain. Insider trading is ethically the same as playing cards with a marked deck. The gains achieved by the insiders come at the expense of other traders who do not have access to that confidential information and therefore are buying shares that soon afterward will fall in value or are selling shares that later will rise in value. The U.S. Securities and Exchange Commission has responsibility for uncovering and punishing insider trading.

INVESTING, HEDGING AND SPECULATING IN THE FINANCIAL SECTOR

In this section we address investing, hedging and speculating in the financial sector specifically in terms of: futures contracts, options and forward contracts, currency trading, stock trading, real estate, along with hoarding and casino gambling. It is instructive to see these activities not in terms of exchange as in product and resource markets but as wagers made on the basis of prices in the future, which absent monopoly-like control of price, are filled with uncertainty and laden with risk.

Futures Contracts. A futures contract is a legally-binding commitment to buy or sell a specific commodity such as wheat or oil or financial product based on the S&P index or Dow Jones index for a fixed price on a specific date in the future. Hedgers are producers and users of commodities who are risk-averse regarding future prices (Daniels Trading, 2008). Both try to reduce that risk by signing futures contracts that call for the producer to sell the commodity at a fixed price and deliver it on a given date in the future to the user who must buy that commodity at that price and take delivery on that date. Producers win and users lose when the price of the commodity on the delivery date is *below* the agreed

price as specified in the contract. Users win and producers lose when the price on the date of delivery is *above* the contract price.

Even though the futures contract on the date of delivery is a zero-sum agreement in which one party eventually wins and the other loses, justice is served as long as they understand in full and accept without reservation the terms of the contract when they commit themselves contractually. In other words, a futures contract meets the demands of justice when the terms are transparent and the parties are free to act. Under commutative justice they are exchanging things of equal value – a clearly stated price for a clearly specified commodity or financial product -- and imposing equal burdens on one another – the uncertainty and risk involved in future price movements *over which neither one has any control*. If, however, one of the parties has control over prices in the future, justice is not served because uncertainty and risk are much lower for the one who controls those prices and therefore that party is not imposing equal burdens on the other. In strictly ethical terms, that contract is unjust and not binding.

A futures contract can be bought and sold multiple times just as a stock can be bought and sold time after time on a stock exchange. Thus the holder of a futures contract can transfer the risk to someone else in exchange for cash. Speculators buy and sell futures contracts through commodity exchanges but are neither producers nor users of the underlying commodities. Unlike hedgers, speculators are risk-inclined regarding future changes in commodity prices (Daniels Trading, 2008). They buy commodity contracts which they regard as *undervalued* today because they expect the future price of the underlying commodity will be higher than the commodity price set forth in that contract and therefore they can expect to sell that contract in the future at a higher price than what they paid for it. They sell commodity contracts they regard as *overvalued* today because they expect the future price of the underlying commodity will be lower than the commodity price set forth in that contract and for that reason the contract itself will sell at a lower price in the future. Speculators win whenever they have predicted future price movements correctly. Otherwise they lose. Unlike hedgers, speculators cannot afford to be obligated under the terms of a contract on its date of delivery because they are in no position to deliver the underlying commodity nor can they take delivery because they have no use for it.

For a futures contract based on a financial product such as the S&P index, the buyer of that contract experiences a gain when the index rises and a loss when it falls. Specifically, a change of one index point in the S&P index represents a gain or loss of \$250.¹ If at the end of the trading day, for example, the index rises by 20 points the person who has purchased that contract captures a \$5,000 gain and the person who sold that contract must transfer

\$5,000 to the account of the person who purchased it. If the index falls, the purchaser must transfer to the seller's account \$250 for each point the index has fallen. This kind of futures contract is bought and sold on either the Chicago Board of Trade (CBOT) or the Chicago Mercantile Exchange (CME) and *provides agents in that market with valuable information that helps inform their decision-making for the day.*

The CBOT and the CME are not the only futures contract exchanges in the United States. The New York Mercantile Exchange specializes in oil futures contracts. The New York Board of Trade provides a market for cocoa, coffee, cotton, orange juice, and sugar. Other futures exchanges operate in London, Tokyo, Sydney, Singapore, and elsewhere (Wikipedia, 2008).

Speculators provide an important service to daily commodity and financial product markets. Speculators, especially those who are specialists in a specific commodity or financial product such as corn or the euro focus attention on future price movements. They are in fact specialists in future price expectations who put at risk their own money on the basis of their analysis of those expectations. Future price expectations in turn influence the daily market price from both the demand side and supply side.

On the demand side, consumers who expect prices to rise in the future are likely to buy today in order to avoid future price increases. Conversely, consumers who expect prices in the future to fall are likely to postpone current spending in order to take advantage of the lower prices in the future. On the supply side, producers who expect higher prices in the future are likely to hold back current production in order to sell more later when prices are higher. Producers who expect prices to fall in the future are likely to sell more today in order to take advantage of those higher prices.

By following exchange activities relating to the buying and selling of futures contracts, consumers and producers are better informed regarding future price movements. Whenever the price of a futures contract itself (not the agreed price as set forth in that contract) for a specific commodity or financial product is *falling* consumers and producers can expect the price of that commodity or financial product to fall in the future and can adjust their current buying and selling accordingly. When the price of such a contract is *rising* consumers and producers can expect the price of the underlying commodity to rise in the future and can apply that information to their own current market decision-making. By informing consumers and producers in their day-to-day decision-making, speculators help determine current market prices.

Options and Forward Contracts. An options contract is similar to a futures contract except that the person holding such a contract has the option of meeting his/her obligations as set forth in the contract or backing out. As with futures contracts, option contracts are exchange-traded. An option to sell a futures contract is called a *put*. An option to buy a futures contract is known as a *call*.

A forward contract is like a futures contract but is more complex. To reduce the risk of a very large gain/loss on the date of delivery, a futures contract is re-balanced every day to the daily spot price of a futures contract with the same agreed price on delivery and the same underlying asset. This practice, known as “mark to market,” reduces the risk that there will be a very large gain/loss on delivery date because the loser on a daily basis must transfer monies to the margin account of the winner.

A forward contract is not re-balanced and therefore exposes the contracted parties to a large gain for the one and a large loss for the other on the date of delivery. Thus there is a credit risk associated with a forward contract in that the seller/producer may not be able to deliver the underlying commodity and the buyer/user may not be able to make payment in full at delivery. Futures contracts are exchanged traded whereas forward contracts are bought and sold over the counter. This difference means that futures contracts are much more standardized than forward contracts.

The risk of failure on the part of the producer or the user of a futures contract on delivery date is borne by the exchange itself thereby limiting credit risk in futures contracts. To illustrate, participants in the New York Mercantile Exchange are required to maintain accounts with deposits sufficient to cover any losses they may experience.

Currency Trading. The currency market is a financial market where currencies are bought and sold in anticipation of the gain from holding one currency versus another. Trades are executed through brokers who provide access to the currency market which is a network of world banks that buy and sell currencies electronically and through that activity provide the essential service of setting currency exchange rates.

If, for example, the U.S. dollar exchanges today for 105 yen and a currency speculator expects that the dollar will exchange for 115 yen next week, that speculator would sell yen and buy dollars today in anticipation of the gain of 10 yen for each dollar sold and exchanged for 115 yen next week. The speculator who anticipates the change in the rate of exchange correctly and buys or sells accordingly captures the gain. Any speculator on the other side of that buying or selling activity who in effect anticipated the rate of exchange

incorrectly suffers the loss. Key to this zero-sum outcome is that the currencies are being bought and sold not for the purpose of exchanging that money for some good or service but for the expected gain in the exchange process itself. The use value/exchange value calculus of buying and selling does not apply to currency speculating. For currency speculators gain and loss originate in the difference in the exchange rate (the currency's price or exchange value) from one point in time to another.

Just as we observed with future prices for commodities, a person actively engaged in buying and selling currencies can hedge against changing currency prices in the future by turning to a futures contract, an options contract, or a forward contract (Srinivasan and Youngren, no date). For more on the currency market, go to www.forextips.co.uk/forex-rates.htm.

Stock Trading. Daily economic affairs in the stock market are not as cut and dried as conventional economic theory suggests. Buying and selling, investing hedging, and speculating can be separated in the abstract but not always in day-to-day economic activity. Actually purchasing shares of stock in a given corporation today is buying and selling in the sense that gain is involved for both the buyer and seller. Certainty, transparency, and reduced risk attend the trade when the sale is executed provided there is a clear and accessible record of the performance of that corporation and corporate insiders have not “cooked the books.”

However, neither the buyer nor the seller of those shares knows for certain what they will yield in terms of dividend stream and share price in the future. Uncertainty, obscurity, and elevated risk attend the holding of those shares in the future. The person holding them to support future retirement is an investor when he/she expects a long-term gain based on dividends and the share price. The person who deliberately buys only shares in corporations with a solid record of paying dividends and slow but steady growth in share price is a hedger. On the other hand, the person who buys shares in corporations with an erratic performance record or no record whatsoever is a speculator.

Whatever the buyer's underlying purpose in these stock purchases, the practice is known as “buying long” and is based on the premise that the stock is undervalued and will increase in price in the future. “Selling short,” on the other hand, is based on the premise that the stock is overvalued and will decrease in price in the future. Selling short is the practice of paying a broker-dealer, for example, or institutional investor such as a pension fund a fee to borrow shares with the promise to replace them at a given date in the future, selling those shares immediately, and replacing them as required at the share price on that

given date. The person selling short pockets a gain if the future price is lower and takes a loss if the price is higher (Federal Register, 2004). Day traders are speculators. So too are those who financially back a theatrical production in the hope that it will have a long and rewarding run on Broadway.

Even so, as we noted already with futures contracts, selling short is not unjust as long as the terms of the contract are transparent and the parties are free to act. If, however, one of the parties has control over the share price in the future, justice is not served because uncertainty and risk are much lower for the one who controls that price and therefore that party is imposing an unequal burden on the other. In strictly ethical terms, that contract is unjust and not binding.

Although it is not defined in the federal securities laws or SRO² rules, “naked” short selling is the practice of selling short without first having borrowed the shares (Federal Register, 2004). Not being able to borrow the necessary shares could happen in the case of a small company with only a few outstanding shares. Under Securities and Exchange Commission rules the seller is allowed three days to deliver the shares to the buyer before that seller is reported for failure to deliver. A sudden increase in failure-to-deliver reports involving the shares of a specific firm suggests some irregularity in the trading of those shares.

Though not illegal *per se*, naked short selling according to the SEC could be a sham or abusive practice in certain instances (Federal Register, 2004) as when a broker-dealer lends the same shares to different short sellers. This abuse can happen because shares typically are transferred electronically and no registered stock certificates ever change hands. Thus, under its emergency rule making authority, the SEC can declare naked short selling legal for some and illegal for others depending on how the Commission responds to changing market conditions and the behavior of lenders and sellers especially when major financial stocks are severely threatened. In July 2008, for example, the SEC exempted market makers³ from a new rule which otherwise prohibits naked short selling of the shares of 17 Wall Street banks along with the two government mortgage guarantors Fannie Mae and Freddie Mac (Forbes, no date).

Naked short selling with the deliberate intent to drive the share price down is illegal. It is unjust because the seller, hoping to capture an ill-gotten gain, necessarily conceals his intent from the lender and thereby violates both the transparency rule and the price control rule. Naked short selling in which the seller has no intention of ever delivering the shares is unjust because it violates the transparency rule. Proving such ill intent -- that the

transparency rule or price control rule has been violated *intentionally* -- makes enforcement difficult and leads at times to accusing the SEC of not doing its job.

Real Estate. Apart from those who buy a house to make it their home and expect to stay there for a long time, a house or similar property can be purchased for the purpose of investing, hedging, or speculating. An investor expects the property to increase in value in the long term and plans to hold it in anticipation of that long-term gain. A hedger purchases the property because other types of investments such as equities and commodities are too risky at the moment. A speculator acquires the property in the expectation of the gain to be made over the short term in a market where property prices are rising rapidly. “Flipping” a house is speculative behavior in that the house is held only long enough to make some improvements which at times can be more superficial than substantial and are expected to increase its resale value by more than the cost of those improvements.

The key to setting apart buying and selling in the real economy from investing, hedging, and speculating in the financial sector is found in what is being purchased and why it is being acquired. With the exception of hoarding, a bunch of bananas, a box of cereal, a gallon of gas for one’s car are consumables in which the buyer and the seller have carried out the use value/exchange value calculus and have decided there is gain for both in the exchange process. Similarly, labor services and physical resources are consumables in the sense that they are used up in the production process and are subject to the same calculus. Thus, buying and selling in the real economy are positive-sum activities.

A real estate holding, a share of stock, an oil futures contract are assets, things of value, which are acquired not for their use value but with the expectation that they will increase in exchange value in the future and can be cast off when that expectation does not materialize. The person who pays for an asset that appreciates in value enjoys a gain. The person who exchanges that asset for cash takes a loss. Investing, hedging, and speculating in the financial sector are zero-sum activities.

A house is a special case. It is both a consumable and an asset. As a consumable, a place to live, it is subject to the use value/exchange value calculus and buying/selling is based on the positive-sum premise. As an asset, it is acquired with the expectation that it will increase in value over time and therefore is based on the zero-sum premise. The new owner seizes the gain, and the former owner relinquishes that gain, if the house appreciates in value. If the house depreciates in value, the new owner is the loser and the former owner is the winner.

Hoarding and Casino Gambling. Though not contractual in nature, hoarding is a form of hedging in that the buyer is betting that an expected shortage of a commodity will drive the price higher and therefore decides to purchase more of that commodity today than usual in order to avoid both the shortage and the anticipated higher price. The buyer who hoards suffers a loss if the future price is lower than today's price and the seller captures a gain. If, on the other hand, the anticipated higher price materializes the seller suffers a loss by selling today and the buyer captures a gain by getting the commodity at today's lower price.

Casino gambling is a form of speculation in which the gambler initiates an exchange involving a small amount of money that is wagered in the expectation that there will be a very substantial payoff. Risk, uncertainty, and obscurity attend every gambling play in which the experienced gambler is likely to know how to reduce the risk – by playing blackjack for instance instead of slot machines, by counting cards at poker table – but is not able to eliminate uncertainty, obscurity, or risk entirely. Unlike buying and selling in the real economy, what is given up in casino gambling is clear and assured, what is gotten in return is not. The betting outcome is nearly instantaneous in a casino where gamblers are enticed to recoup their losses by continuing to bet even though it is well-known that the odds overwhelmingly favor the house.

SUMMING UP

Every exchange in product and resource markets entails gain for the persons involved provided they are well-informed and free to act: what is gotten in the exchange (use value) is more highly valued than what is given up (exchange value). Thus, every exchange in the real economy is based on the positive-sum premise. Under competitive market conditions, exchange value should not vary from one person to the next. While exchange value is determined by market conditions, use value is determined by the value systems of the different persons involved in the exchange.

Without that gain, exchange cannot be carried out. However, there must be limits to the amount of gain in order to prevent one party from taking advantage of another and to assure that market exchange serves everyone fairly and effectively and not just those with the power and will to turn gain into excess. Those limits are grounded in the principles of commutative justice, distributive justice, and contributive justice. Even though our focus has been on U.S. economic and financial institutions, these principles apply generally in any market economy.

Commutative justice states that buyer and seller in the marketplace and worker and employer in the workplace have two duties: exchange things of equal value and impose

equal burdens on one another. Gain is realized when use value > exchange value. Even so, justice is served only when equal value means equal exchange value.

When a market is reasonably competitive, exchange value normally does not fluctuate markedly from day to day and is the same or nearly the same for all buyers on the same day. Thus gain is justified when use value > exchange value restrained by competition.

A problem arises when the market does not impose this restraint, and agents are free to act without restraint thereby realizing an ill-gotten gain. Commutative justice informs both parties that the only justifiable gain is one that does not deprive the other party of the gain that is rightfully his/hers. Thus gain is justified when use value > exchange value restrained by faithful adherence to commutative justice in a situation where competition alone does not provide the necessary restraint.

Distributive justice requires the superior to distribute the benefits and burdens of the group his/her subordinates in some equal fashion. Distributive justice limits ill-gotten gain because the fair-minded superior assures that what is gotten and what is given up are alike for everyone in the same or similar circumstances.

Contributive justice asserts that insofar as a member receives benefits from the group, he/she has a duty to maintain and support the group. Belonging to a group means that every member has a duty to reject any ill-gotten gain that derives from taking advantage of others in the group.

In sharp contrast, investing, hedging, and speculating in the financial sector are based on the zero-sum premise that one agent's gain is another's loss. Investors, hedgers and speculators are driven by the uncertainty and risk associated with future price movements. Hedgers avoid risk at the expense of the greater gains possible. Speculators take on risk for the greater gains possible. Investors can be risk-averse, risk-inclined, or both.

Even though the futures contract on the date of delivery is a zero-sum agreement in which one party wins and the other loses, justice is served provided the terms are transparent and the hedger and speculator involved are free to act. Under commutative justice they are exchanging things of equal value – a clearly stated price for a clearly specified commodity or financial product -- and imposing equal burdens on one another – under conditions of uncertainty and risk associated with future price movements provided *neither one has any control over the price*. If, however, one of the parties has control over future prices, justice is not served because uncertainty and risk are much lower for the one who controls those

prices and the controlling party is not imposing equal burdens on the other. That contract is unjust and not ethically binding.

Speculators provide an important service to daily commodity and financial product markets. Speculators, especially those who are specialists in a specific commodity or financial product such as corn or the euro focus attention on future price movements. They are specialists in future price expectations who put at risk their own money on the basis of their analysis of these expectations. Future price expectations in turn influence the daily market price from both the demand side and supply side.

Buying and selling shares of stock in a corporation involve gain for both the buyer and seller provided certainty, transparency, and reduced risk attend that trade. However, neither the buyer nor the seller knows for certain what those shares will yield in the future. Uncertainty, obscurity, and elevated risk attend the *holding* of those shares. The person holding them to support retirement is an investor when he/she expects a long-term gain based on dividends and the share price. The person who buys only shares in corporations with a solid record of performance is a hedger. The one who buys shares in corporations with an erratic performance record or no record whatsoever is a speculator.

“Buying long” is based on the premise that the stock is undervalued and will increase in price in the future. “Selling short” is based on the premise that the stock is overvalued and will decrease in price in the future. The person selling short pockets a gain if the future price is lower and takes a loss if the price is higher. As noted with futures contracts, selling short is not unjust as long as the terms of the contract are transparent and the parties are free to act. If, however, one of the parties has control over the share price in the future, justice is not served because uncertainty and risk are much lower for the one who controls that price and therefore the controlling party is imposing an unequal burden on the other.

Naked short selling with the intent to drive the share price down is illegal. It is unjust because the seller, hoping to capture an ill-gotten gain, conceals his intent from the lender and violates both the transparency rule and the price control rule. Naked short selling in which the seller has no intention of ever delivering the shares is unjust because it violates the transparency rule.

The key to setting apart buying and selling in the real economy from investing, hedging, and speculating in the financial sector is found in what is being purchased and why it is being acquired. With the exception of hoarding, buyers and sellers in product and resource markets have carried out the use value/exchange value calculus and each one has decided

there is gain in the exchange process. Buying and selling in the real economy are positive-sum activities. They can degenerate into zero-sum activities whenever the limits on gain which are imposed by competition break down and human beings set aside their duties under justice to take hold of the available ill-gotten gain.

A share of stock, an oil futures contract, a real-estate holding are assets which are acquired not for their use value but with the expectation that they will increase in exchange value in the future and can be cast off when that expectation does not materialize. The person who pays for an asset that appreciates in value enjoys a gain; the person who exchanges that asset for cash takes a loss. Investing, hedging, and speculating in the financial sector inevitably are zero-sum activities. The gains achieved are ill-gotten and unjust only if one of the parties is not free to act, has control over the price, or is not fully informed as to the risks involved.

Endnotes

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1. The dollar gain/loss for every point change in the Dow Jones is \$10; for the NASDAQ it is \$100 (Investopedia, no date).
2. An SRO is a self-regulatory organization such as the New York Stock Exchange.
3. Market-makers buy and sell shares in order to match buy/sell orders and thereby help stabilize the market.

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