Published on *Adam Smith Institute* (http://www.adamsmith.org)

High Frequency Trading: Yes, Smith Did Say This Would Happen [1]

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It appears that all of these nefarious high speed traders are not, as all had thought, making vast profits. Rather, they've come up against a limitation to the system which is seriously reducing their profits. Meaning that regulation and action to stop HFT is really rather moot [3]:

> Now it appears the advantages of speed are starting to dissipate, and being the fastest trader isn?t worth what it once was. High-frequency trading profits are expected to fall 35 percent this year, 74 percent below their peak in 2009. In an ironic twist, high-frequency traders have gotten so fast, they seem to have outrun their own profitability.

The specific problem they face is that their systems are now faster than those of the exchanges. Thus throwing money at getting faster doesn't do you much good. Rather like building a motor car that tops out at 250 mph when the speed limit is 70. Possible as a rich man's toy but not necessarily a profitable method of business. The car maker might make money but it's only the bragging rights for the user.

But the thing is Smith, Ol' Adam, did point out that this was the sort of thing that would happen. Someone might spot a new method of making excess profits: they go off and do so. Others note those excess profits and follow. In time, those excess profits get competed away and, with many a wobble, profits decline to normal levels again. In this very manner new profit opportunities are supplied with the capital necessary to exploit them and when they're exploited our adventurous capital goes off to look for further excess opportunities. In which manner the economy becomes ever more efficient and we all collectively get richer. Hurrah!

In an example of that search for further excess profit possibilities those HFT methods appear to be moving from the stock market over to the commodities markets [4]. At which point Hurrah! again as they will become more efficient and we'll all get collectively richer again.

How about that, eh? Free markets lead to capital being optimally allocated. Who would have thought it? The chase for excess profit leads to it being competed away and in the process we all get richer.

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[1] http://www.adamsmith.org/blog/economics/high-frequency-trading-yes-smith-did-say-this-would-happen
[2] http://www.adamsmith.org/taxonomy/term/5833
[3] http://www.businessweek.com/articles/2012-10-16/how-high-speed-traders-outraced-the-profits
[4] http://streetwiseprofessor.com/?p=6665
[5] http://disqus.com/?ref_noscript
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