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Common Error No. 45 [1]

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45. "Speculators are parasites who produce nothing."

Speculators have had a bad press. Along with landlords, corn merchants, and tax gatherers, they have been the whipping boys of demagogues. They are often thought of as drones who "buy in the cheapest market and sell in the dearest," adding nothing of value in the process. Typically the speculator buys up something they think will be in short supply later, and can therefore sell for more than they paid.

Yet the speculator helps to smooth out uncertainty. The farmer who plants in the spring does not know what prices might be like when the harvest is in. He might prefer a guaranteed price than face that uncertainty. Someone who buys the crop now offers a sure price; the crop might sell for more than that, but it could also be less. The speculator can carry that risk instead of the farmer, and profit from it if he is right.

This is what speculators do; they handle risk. They live and trade by being able to call the future more accurately than others. They give people certainty and security now, in return for a higher return for themselves in the future if they are correct. Speculators can lose. The goods they buy now at a guaranteed price might plunge in value later. Unlike many farmers and merchants, the speculator can carry those losses.

Speculation in currencies is similar. A manufacturer planning to sell in another currency might prefer the certainty of a fixed value, rather than take chances on the future exchange rate. The speculator will sell him that currency now, at a price he thinks it will exceed in the future.

As long as speculators are right more often than wrong, they can prosper, and they smooth market volatility in the process. So far from being unproductive drones, speculators actually offer a valuable and skilled service: they manage risk.

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