Big Players

The general theory of Big Players

Big Players are privileged actors who disrupt markets. A Big Player has three defining characteristics. He is big in the sense that his actions influence the market under study. He is insensitive to the discipline of profit and loss. He is arbitrary in the sense that his actions are based on discretion rather than any set of rules. Big Players have power and use it.

Big Players disrupt markets by reducing the reliability of expectations. This disruption occurs in two ways. First, Big Players make each market participant less able to predict the future. Second, Big Players make the market process less likely to weed out traders who are bad at forecasting, and more likely to weed out traders who are good at forecasting. The first way is discussed in Koppl and Yeager (1996). The second way is discussed in Butos and Koppl (1993) and Koppl and Langlois (1994). I will treat each in turn.

Big Players and cognitive expectations

The actions of Big Players are hard to predict, but they influence the market. Big Players divert a portion of entrepreneurial attention away from more narrowly economic data onto aspects of the economic environment – actions of policymakers – that are inherently subject to unpredictable change. (For models of the allocation of attention see Baumol 1990, Gifford 1998, Radner 1975, Radner and Rothschild 1975.) Traders must pay attention to the actions and possible actions of the Big Player. Doing so means diverting attention from other factors, the fundamentals. (One would say the “other fundamentals” if one wished to call the Big Player a fundamental factor.) But the object onto which the diverted attention is moved is intrinsically hard to
predict. Thus there is a net loss of prescience in each actor’s interpretation of the future.

Economic expectations are based, implicitly or explicitly, on assumptions about what people will do. A judgment about what bad weather will do to wheat prices is based on reasonable assumptions about the actions of many persons, each of whom is subject to the discipline of profit and loss. There is little chance that idiosyncratic behavior of wheat farmers or wholesalers will prove our judgment mistaken. In contrast, a judgment about how the central bank will respond to, say, weakness in the manufacturing sector rests on assumptions about what a few known individuals will do. However reasonable these assumptions may be, there is always the chance that the persons in question will act out of character and disappoint our expectations. Fed watching is an inexact science.

The vulnerability of expectations to disappointment in particular cases is illustrated by Machlup’s three propositions discussed in Chapter 1. Consider again his third proposition. “If, because of heavy withdrawals of foreign deposits, the banks are in danger of insolvency, the Central Bank Authorities will extend the necessary credit” (1936, p. 64). As a description of general trends, this seems a sound rule of thumb. But particular cases may go either way. “It will make a great difference,” in Machlup’s example, “whether Mr. Keynes or Professor von Hayek is governor or expert adviser of the central bank” (1936, p. 68).

Discretionary policymaking focuses entrepreneurial attention on the politics of the market. For the reasons just outlined, these are typically less knowable than more narrowly economic influences. When discretionary policymaking thus reduces the knowability of markets and the reliability of expectations, it devalues skill and makes luck count for more. Economic actors have less reliable and more transient knowledge about their environment when discretionary policymaking is an important dimension of that environment.

The presence of a Big Player forces other market participants to use an ideal type of low anonymity in their models of the market. The Big Player creates a situation of open reflexivity. The concept of open reflexivity was explained in Chapter 6. As I indicated there, open reflexivity frustrates coordination.

The argument of this subsection is similar to Machlup’s argument in his “Why Bother with Methodology?” (1936), where he applies ideas of Schutz (1967). Machlup’s argument concerns epistemological problems of economic theorists. Mine derives from applying his analysis to epistemic problems of economic actors.