The Effect of Trading Option Type Claims on the Efficiency of Experimental Security Markets

Charles Plott and Shyam Sunder

Recent theories in economics claim that markets solve not only the classical allocation problem of getting buyers and sellers together efficiently but that markets can also perform another function. Namely, markets can aggregate and disseminate information. By watching the price of a stock, “outsiders” can infer what insiders know. This is a variant of the rational expectations hypothesis. If a group of insiders are competing for securities in the market, someone outside the firm can learn almost anything about the company by simply watching the economic consequences of the behavior of these people. This incredible idea is that markets themselves can serve to aggregate and disseminate information that no one in particular has an interest in allowing other people to know. Our original research was based on the assumption that this idea is bananas. In this talk I will provide you with some brief impressions of what we have observed.