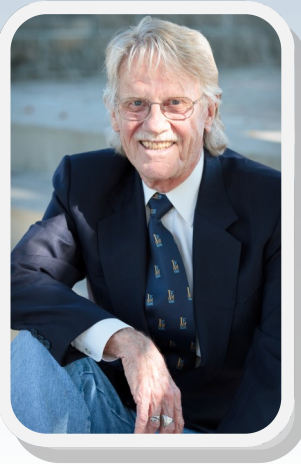


## President's Corner By Vernon L. Smith



IFREE has updated its website!  
Please explore at your leisure:  
<http://ifreeweb.org/>

Have you noticed that the public schools are widely perceived as failing, whereas U.S. higher education is seen as performing far better? The reason, often noted, is that there are serious impediments for both students and teachers to choose or switch between public schools. Over time, the right to choose between alternatives disci-

plines performance and quality even if most do not actually exercise that option.

It's timely that two recently IFREE-funded research proposals use experiments to study choice in more abstract decision frameworks that relate to these issues.

Yan Chen, University of Michigan, models the problem of agents (students, parents) not knowing their preferences and information is costly. Public school choice reform uses procedures for matching schools and students, given one or each side's rank order preference for the other. How do alternative procedures influence incentives to acquire better information concerning one's own preferences versus the preferences of others? Efficiency is best served where each side is motivated to acquire information to better know only their own preferences.

Abhijit Ramalingam, University of East Anglia, models the problem of "teams" (schools) composed of individuals, with a common outcome objective. This is the public good or social dilemma problem where individuals have an incentive to free ride on others' effort contributions. A source of discipline, compared to all members being locked into a particular group, is the prospect that team members can vary, or switch, their contribution to other teams. His experiments will examine the effect of introducing such a "market for talent" on the extent of free-riding.

Two of our most recent grants concern "matching markets," the development of which has important origins in experimental economics. The significance of this development was recognized in 2012 when Alvin E. Roth shared the Nobel

Prize in economics: "Through empirical studies and lab experiments, Roth and his colleagues demonstrated that stability was critical to successful matching methods. Roth has also developed systems for matching doctors with hospitals, school pupils with schools, and organ donors with patients."

IFREE has recently updated its Mission Statement which I'd like to share in the President's Letter:

*IFREE Promotes Human Betterment by Using Experimental Economics to Improve Our Understanding of Exchange Systems.*

IFREE:

- ⇒ funds primary research in market and personal exchange systems.
- ⇒ sponsors participatory, hands-on, educational, workshops; interdisciplinary academic discussions; and outreach programs for those outside the economics profession.

### Small Grants Recently Funded

**Radovan Vadovic, Till Gross, Carleton University, Ottawa, Canada**

***"Strategic Investment: Do Executives Exploit the Market?"***

The past fifty years of experimental research have shown that markets do an excellent job at aggregating information and allocating resources to their most productive uses. Occasionally we do observe signs of mispricing or insider manipulation. It is crucial to understand when markets have underperformed so that we are better prepared to deal with consequences of financial turmoil, such as what followed the real-estate bubble of 2008. This research concentrates on an argument by Brandenburger & Polak (1996), who show that in the presence of mispricing, firms' executives (who are paid in part according to the stock price) may be able to exploit the market by investing strategically. When the stock is overpriced, they may invest too much; and vice-versa when the stock is underpriced. This typically leads to real economic losses. The argument relies on two key ingredients: (i) the market prices have to misrepresent firms' fundamentals and (ii) at least part of executive compensation has to derive from the stock price (e.g., stock options or stock grants). In the past decade we have witnessed both – a major financial bubble and an unprecedented growth in the share of stock-price-based incentives. We propose to conduct the first empirical



# IFREE Spotlight

## SMALL GRANTS ANNOUNCEMENT

IFREE is proud to announce that since the inception of the Small Grants Program in 2010, 29 grants have been awarded, 23 to domestic universities and 6 to universities outside of the U.S. Research papers coming out of the grants are being [added to our website](#) as we receive them.

## UPCOMING WORKSHOPS AND CONFERENCES

Visit our [Conferences and Workshops page](#) online

### The 4th Experimental Economics Conference and Workshop

Centro Vernon Smith de Economía Experimental at the University of Francisco Marroquín, Antigua, Guatemala  
The conference will be held February 26—27, 2016 and the workshop in June 2016

### Vernon L. Smith High School Workshop in Experimental Economics

Chapman University from June 27—July 1, 2016.

### Summer Scholars Program

Chapman University from June 27—July 29, 2016.

### UAA Undergraduate Workshop

University of Alaska Anchorage held this winter; date to be determined

### Summer High School Workshop and Scholar Program

Center for the Study of Neuroeconomics at George Mason University  
Dates to be determined after March 1, 2016



## Small Grants Recently Funded *continued...*

test of this conjecture by applying the methods of laboratory experimentation. In addition, we explore a promising possibility of mitigating the threat of strategic investment by restricting the share of stock-price-based incentives in managerial compensation. This will have implications for economic design and regulation of executive contracts.

### **Marco Castillo, Ahrash Dianat, George Mason University** ***“Experiments on Strategic Behavior in Two-Sided Matching Markets”***

“Matching theory” has informed the design of institutions in areas as diverse as kidney exchange, entry-level labor markets, and school choice. These institutions often operate as centralized clearing houses, in which participants submit rank-order lists of their preferences and a particular algorithm calculates the final outcome, i.e., who is paired with whom in the final matching. There are some environments where agents on one side of the market have an incentive to misrepresent their preferences in order to bring about a more favorable outcome. In these situations the particular outcome that is finally implemented depends on agents’ ability to behave strategically either in isolation or as a group. Our work uses laboratory experiments to investigate whether the ability of agents to coordinate on misrepresenting their preferences in a particular fashion depends on features such as how profitable and safe it is to misrepresent and also the size of the market. We hypothesize that strategic behavior will be more likely to arise where it is more profitable and safer. In addition, we hypothesize that agents will coordinate on strategic behavior in small markets but not in large markets. However, we predict that coordination in large markets can be obtained by starting with small markets and incrementally adding players who are aware of the market’s history.

### **Yan Chen, University of Michigan**

#### ***“Information Acquisition and Provision in School Choice”***

In school choice in the real world, providing information on school test scores to low-income families has been shown to increase the fraction of parents choosing higher-performing schools. When students do not know their preferences over schools and information acquisition is costly, we show theoretically that, while both strategy-proof and non-strategy-proof mechanisms incentivize students to acquire information on their own ordinal preferences, which improves efficiency, non-strategy-proof mechanisms also induce students to acquire information on others’ preferences, which might be welfare reducing. We propose to test our theory of endogenous information acquisition in school choice in the laboratory, using two canonical mechanisms, the Boston mechanism, which is conducive to strategic manipulation, and the Deferred Acceptance mechanism, which is strategy-proof. We expect that students’ incentives to acquire information vary across mechanisms.

### **Abhijit Ramalingam, University of East Anglia; M.T. Aditya Srinivasan, Berklee College of Music; Brock V. Stoddard, University of South Dakota; and James M. Walker, Indiana University**

#### ***“The Market for Talent: Competition for Resources and Self Governance”***

Free-riding is a ubiquitous problem in social dilemmas and leads to severe and persistent losses in efficiency. Solutions proposed to raise cooperation levels within groups and teams include sanctioning or punishment and inter-group competition for rewards. These solutions are interventionist in that they change incentive structures to modify behavior. By contrast, we propose to examine the effectiveness of competition inherent in the production process which does not require the imposition of additional mechanisms, changes in the payoff/incentive structures or the intervention of designers. (For example, think of teachers at a particular public school as a team, delivering ‘education’ for the students. Suppose, however, that different schools compete for teachers who are free to move between schools in response to each school’s demand.) One way members could attract new members to their team is to increase their input (and hence their output), thus signaling higher earnings potential in their team. That is, interaction between teams in a naturally occurring ‘market for talent’ can itself provide a boost to team effort. Our experiment will examine competition in the market for talent where teams compete over the resources of a common member. To capture the dynamic nature of team composition, we will include treatments wherein members can ‘opt out’ of a team in favor of solo careers and where members can vote to ostracize team members.

### **Ro’i Zultan, Ella Segev, Ben-Gurion University of the Negev**

#### ***“Asymmetric Sequential Auctions”***

Auctions are all around us, from government procurement procedures to on-line platforms such as eBay. An auction designer—be it the government or an individual—seeks to achieve the best outcome in the auction. If the bidders in the auction are not evenly matched, competitive pressure is low and the auction may not yield the desired outcome. In our experiment the theoretical analysis suggests that it may be beneficial to give the weak bidder (s) an advantage in the form of allowing them to bid after observing the bid(s) of stronger player(s). This may not only increase expected revenue but also increase the weak bidder’s expected payoff and can thus serve as a tool to encourage participation of weak bidders. We study sequential auctions, in which two or three bidders place bids one after another, with all previous bids observable to the current bidder. Our experiments will test whether such sequential bidding is better suited to auctions with asymmetric bidders than simultaneous auctions, in which all bidders place their bids without knowing the others’ bids. We also test how sequential auctions fare when the auction designer only has partial information about who is the stronger and who is the weaker bidder. Specifically, we predict that identifying the strongest bidder—and placing this bidder first—is sufficient to obtain a satisfactory outcome in terms of revenue.



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## Build IFREE

### **IFREE's Mission Statement:**

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At the heart of IFREE are the contributors who bring life to the IFREE mission through their financial support of projects funded by IFREE.

IFREE, founded in 1997, is a public 501(c)(3), tax-deductible charitable foundation. Contributions made to IFREE can be provided as general support or directed to a specific research or outreach program. To learn more about the work of IFREE please contact us!

*Your Support Makes a Difference!*

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