

President's Corner By Vernon L. Smith

The 2009 newsletters have given me a chance to stay in touch with you, and I hope they've served to keep you informed about this year's IFREE-funded research projects, the IFREE-sponsored high school and graduate workshops, the intern and student support at Chapman, GMU, University of PA, the IFREE-sponsored speaker series at Chapman, and the outreach experimental economics workshop in Lithuania.

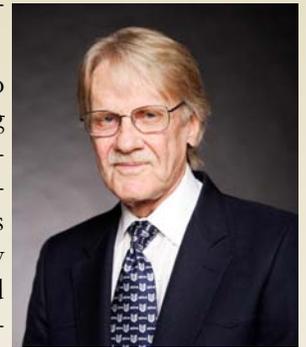
I think it's good performance that your dollars directly support these activities, with less than 7 cents per dollar going for supporting services such as accounting review and part-time assistance for the website and newsletter. What makes IFREE tick is the Board of Directors and the Officers, all of whom are volunteers and who keep their eyes on the ball: the IFREE mission statement. In the upcoming year, our chief aim is to continue funding the international graduate workshop, the high school workshops, the summer Intern Program, the speaker series at Chapman, student support, and research projects which the Proposal Evaluation Committee recommend and the Board approves.

In this newsletter, you'll be able to meet some of the students who came from far 'n' wide to attend the six-week Intern Program that IFREE funded at Chapman

University this summer. Also, you'll get to see how IFREE-funded software has served to facilitate new and planned research in financial economics.

Before I sign off, I want to report more good news following up on the IFREE-sponsored experimental workshop in Lithuania. The ISM University lab is now a central part of ISM's new focus on lab and field experimental methods. During this private university's entrepreneurship week in November, Lithuanian high school students have taken part in demonstration experiments that illustrate the power of laboratory economics. There is also a group working to set up university-run internal prediction markets for major events in Lithuania. Such markets are common in the United States and Europe since our experimental colleagues at the University of Iowa initiated them as the Iowa Presidential Stock Market in 1988.

Happy holidays, and I will be back with you in the New Year....Vernon....



IFREE Financial Markets Research Leads into Zocalo

IFREE has been supporting the development of software to aid in research on a wide range of topics that arise in financial markets. Here are three examples:

- Naked short sales, price volatility, and bubbles.

A naked short sale occurs when a seller of shares neither owns shares nor borrows them from a long term holder for delivery to the buyer. Naked sales now happen routinely in the stock market. In effect, shares are created out of the (electronic) inkwell, much as money is created when a commercial bank makes a loan. Normally, or tra-

ditionally, as when a customer of a brokerage firm sells short, the brokerage firm delivers shares out of the pool of long shares that customers are holding in their account. Hence, the firm's customers cannot sell short more shares than are actually held by customers in that firm's "street name." The practice of naked short selling is controversial, but the objective in this example is to explore its effect on behavior and a stock's performance—price volatility and momentum during bubbles.

- Periodic "call" markets versus continuous trading.



IFREE Spotlight

Seven interns spent six weeks during the summer of 2009 in the IFREE-sponsored Experimental Economics Intern Program at Chapman University. They highlight their experiences below:

Pete Abbate, *George Mason University, 2011*

“This internship gave me a chance to learn about myself as well as economics, and it helped me to develop intellectually in a way that my classes (at least in recent memory) have failed to provide. Close examination of experiments has helped me better understand how to begin when designing an experiment and given me a glimpse of exactly what can go wrong – or right – once you bring subjects into the lab.”

Joy Buchanan, *Chapman University, 2011*

“The summer internship program is a great opportunity to learn about experimental economics and be part of a diverse intellectual community. This internship has been more useful and enjoyable than any economics class I have taken (and the books are free!). ‘Thank you’ to everyone who made this possible.”

Michael Gamboa, *Troy High School, 2010*

“As an intern I have gained valuable insight into the field of experimental economics. The reading club/discussion we had each morning was an excellent supplement to the internship because I was able to further my knowledge in natural law, psychology, and other topics of interest. The fact that there were others there to discuss the information I took in was of significant value.”

Matt McMahon, *Chapman University, 2014*

“During the summer of 2009 I learned a lot about economic theory. Personally, I learn the best through conversation; I was afforded the opportunity to work and interact with faculty who helped me develop my understanding of the scientific process through lots of one-on-one interaction.”

Maciej Pisarek, *London School of Economics, 2011*

“The summer internship at ESI was a great experience. Since my home university does not offer courses in experimental economics, it was an opportunity for me to grasp the rudiments of this field. Through analyzing data from different projects, I have learned how one can design and implement economic experiments in the lab. I have discovered that they can be used in testing the predictions of economic theory as well as shedding some light on the intricacies of human behavior and interactions. I am grateful to IFREE for inviting me to Chapman University and letting me participate in this internship.”

Karl Schurter, *University of Virginia, 2011*

“What sets this program apart from others is the breadth and depth of exposure to the subject which it provides for the interns. Because of my involvement in this program, my perception of economics is evolving. Entering the program, I held immature views of economic inquiry, but I have ‘graduated’ from old habits of shifting supply and demand curves in trying to solve every problem. Our discussions regularly introduced new perspectives and shed light on facets of economic questions I would never have discovered otherwise.”

Matt Simpson, *Iowa State University, 2013 (Ph.D.)*

“The breadth [due to this internship] was particularly great. Not only did we talk about economics, but we also ventured into cognitive science and philosophy of mind as well as the connection between evolutionary biology and social conventions. I have a feeling I’ll be thinking about both of those topics for a long time. Assisting with different experiments was also useful in understanding how to design them to better answer a particular question.”

Andrew Smyth, *Florida State University, 2013 (Ph.D.)*

“I first became familiar with experimental economics in a class taught several years ago by Profs. Vernon Smith and Bart Wilson at my alma mater, George Mason University. That class sparked a desire which subsequent IFREE-sponsored summer internships have stoked: to make experimental economics one of my concentrations in graduate school. In brief, my summer internship was an outstanding, one-of-a-kind, learning experience, and I would like to thank IFREE for making it possible.”

Jake Troesh, *Chapman University, 2012*

“I learned a lot this summer during the internship just being in such an intellectual community. Being involved with the morning discussions on economics was a blessing also in discovering how much I learned from various viewpoints. I learned a lot more from this internship than I could have imagined I would.”



Suppose stock ownership can change only occasionally in a sealed bid exchange—a call market—of shares at a single market clearing price at call time. And suppose continuous trading occurs in a futures prediction market for the call clearing price. The first market is for all those wishing to change ownership title; the second is for short term speculation based on variation in information release. call markets have low price volatility compared with continuous trading. Would maintaining two markets, as indicated, afford long term investors a less volatile means of changing title, while serving the needs of short term information and liquidity traders?

- Liquidity events and share pricing.

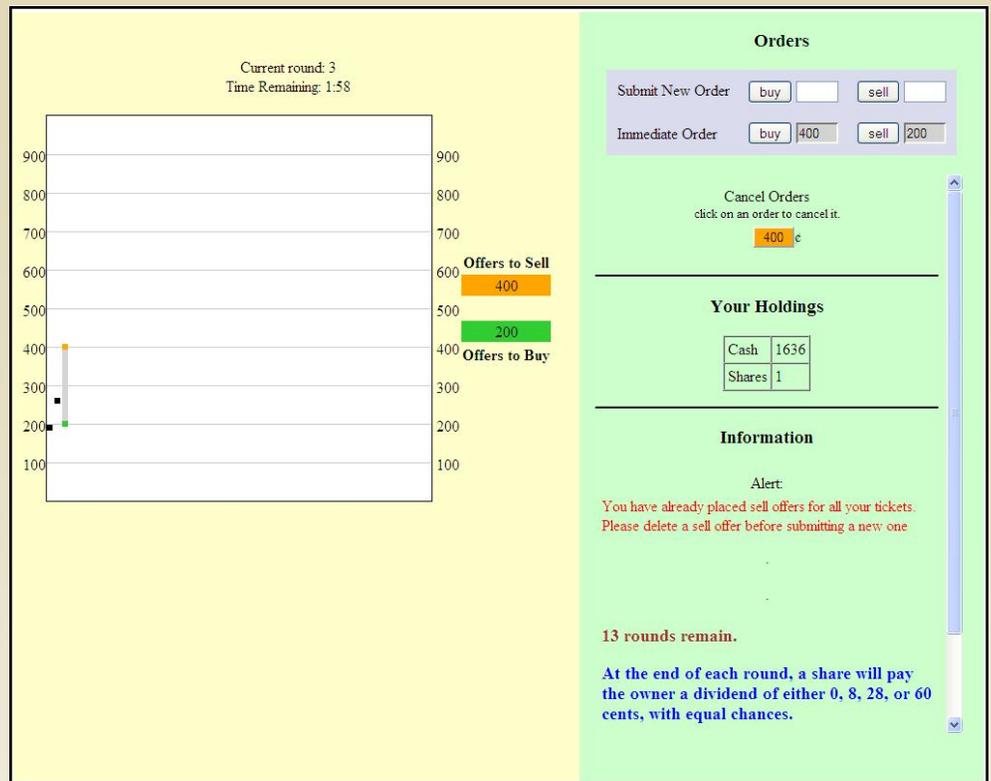
In finance theory, “liquidity events” have to do with large cash purchases or sales of shares. The question is how markets react—over-reaction, under-reaction, volatility—to large infusions of cash or shares, as in buyouts and new share offerings.

The software, called “Zocalo”, is being developed by Dr. David Porter at the Economic Science Institute at Chapman University, along with Chris Hibbert. This commercial grade software will be available as an open source program, at no cost to those desiring to use it in their experimental research. Zocalo uses new technology to run continuous markets on the internet with robustness to shocks (easy reentry from network or computer failures). It supports long-running prediction markets, as well as short term laboratory experiments.

According to the researchers, this software is completely “open source”, which means that anyone can help maintain and enhance it, and anyone can use it. There are downloads for several different operating systems and configurations. Any Linux box, XP or Macintosh can support the software and act as a server. Clients are connected through the web.

So far, at least five IFREE supported research papers on financial market topics have been produced, with more in the works. The more recent work has used Zocalo:

- Robin Hanson, Ryan Oprea, and David Porter. “Information Aggregation and Manipulation in an Experimental Market”. *Journal of Economic Behavior & Organization*, Vol. 60, pp. 449–459, 2006.
- Brice Corgnet, Praveen Kujal, and David Porter. “The Effect of Reliability, Content and Timing of Public Announcements on Asset Trading Behavior.”



A view from the subject's screen in an asset market experiment.

- Ryan Oprea, David Porter, Chris Hibbert, Robin Hanson, and Dorina Tila. “Can Manipulators Mislead Market Observers?”
- Dorina Tila and David Porter. “Group Prediction in Information Markets With and Without Trading Information and Price Manipulation Incentives.”
- Shengle Lin. “Inertia and Underreaction in Asset Prices: An Experiment.”

Zocalo can be found at <http://zocalo.sourceforge.net> or contact Jennifer Cunningham at jcunning@chapman.edu if you would like more information.

IFREE wants to keep you informed! Please email info@ifreeweb.org with your preferred contact information.

For the most in depth and up to date information please visit our website!

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To advance the understanding of exchange systems and the testing and application of market-based institutions by:

- *funding* basic research in economics through experimental methods,
- *supporting* the scholarly development of students and pre- and post-doctoral visitors,
- *sponsoring* innovative hands-on participatory learning in experimental economics in a variety of settings, and
- *promoting* extended discussion of experimental economics research applications to policy.

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