

Department of Decision Sciences

Occasional Seminar

Package Markets: Eliminating Exposure in Markets for Substitutes

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Abstract

This paper investigates the exposure problem in markets for items that are substitutes. It is well known that in multi-item auctions an exposure problem can occur when items are complements (the value of winning a set of items exceeds the sum of the values of winning each item individually). In a market setting, an exposure problem can also occur when items are substitutes (the value of a set of items is less than the sum of the values of owning each item individually). For example, a person may be reluctant to sell their house and buy one they prefer if there is a risk that they will make one but not both transactions. Making just one transaction would leave them with either no house or two houses which could be worse than simply sticking with their current house. We find that such exposure problems do occur. In a standard experimental double auction only 20% of the potential gains from trade are realised. However, in a package market that allows trading using swaps, the problem is alleviated and 89% of the potential gains are realised. Package markets have the potential to increase efficiency in a range of settings, for example reallocating licenses to use radio spectrum.

(with Luke Lindsay)