"Market Selection and the Information Content of Prices," by Alp Atakan and Mehmet Ekmekci


Abstract:

We study price formation in an economy where buyers with unit demand decide to purchase one of two possible goods which are traded in two distinct markets. The goods traded within each market are identical, common-value objects and we model the price formation process as a large uniform-price auction. Before the auctions, bidders receive informative but imperfect signals about the state of the world and choose to participate in one of the markets. Our main result shows that if market frictions lead to uncertain gains from trade in any of the two markets, then there is no equilibrium where prices aggregate information. In contrast, if both markets are frictionless, then prices fully aggregate information. These findings are driven by how bidders self-select across markets: Better-informed bidders select frictional markets while uninformed, pessimistic bidders select the safety of frictionless markets. Our results suggest a novel mechanism through which market imperfections in one market can have widespread effects across all linked markets.