Efficiency of Experimental Security Markets with Insider Information: An
Application of Rational-Expectations Models

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The study reports on the ability of competing models of market information integration and dissemination to explain the behavior of simple laboratory markets for a one-period security. Returns to the security depended upon a randomly drawn state of nature. Some agents (insiders), whose identity was unknown to other agents, knew the state before the markets opened. With replication of market conditions the predictions of a fully revealing rational-expectations model are relatively accurate. Prices adjusted immediately to near rational-expectations prices; profits of insiders were virtually indistinguishable from non-insiders; and efficiency levels converged to near 100 percent.