

# Prediction Markets, Speculation and Manipulation

Prediction markets have become popular in the recent years as a tool for aggregating information spread across individuals. The use of such markets as an aid to decision making within large corporations is growing. These markets are expected to aggregate information efficiently and generate predictions of future events . The aim of this paper is to look at corporate prediction markets and possibilities of manipulation of price in these markets. The motivation for this paper comes from noting the fact that unlike other financial markets, the participants may care about not only the financial gains, but also the prices that realize. Preferences over price realizations would provide motive for manipulation. There exist any number of papers on manipulation in financial markets. Most of this literature tend to focus on purely financial motives for manipulation, i.e insider trading, coupled with a rational expectations setting. As expected, manipulation is not optimal in the long run and we end up with robust market efficiency results. But it is not clear whether such robustness can be expected in prediction markets whose primary purpose is to gather information. In reality, actual financial stakes in prediction markets are small, at least in the US, mostly due to stringent anti-gambling laws. On the other hand, the prediction market results are potentially used in corporate decision making. Hence there might reasonably exist non-financial manipulation motives if participants have preferences over subsequent decisions made. The key questions I would eventually like to answer with the current project are the following:

- Would manipulation matter for the eventual prices/predictions?
- Under what conditions would manipulation matter?
- How can we detect it empirically?

The answer to the first question is tied to the efficiency of such markets, and the last two questions are attempts to link efficiency of a market to its microstructure theoretically and empirically.