Pareto Improvement and Agenda Control of Sequential Financial Innovations

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Abstract

In a model of an exchange economy under uncertainty with two periods, one physical good, and finitely many states of the world, we show that for every (complete or incomplete) market span there exists a sequence of securities such that as they are introduced into markets one by one, the prices of any security is not affected by the subsequent introduction of newer securities. Given the absence of pecuniary externalities, this result implies that every stage of such sequential financial innovations is Pareto improving. An implication of this result on financial innovations via an unanimous voting rule is also explored.