

Does insider trading raise stock market volatility?

Stock market volatility is not news, but why does the degree of volatility vary across countries? According to Julian Du, an Assistant Professor at the Chinese University of Hong Kong, and Shang-Jin Wei, an Advisor in the IMF's Research Department, it has a lot to do with insider trading. In a new IMF Working Paper, they conclude that countries with more insider trading have more volatile stock markets, even after taking into account the liquidity and the maturity of their markets and the volatility of real output and monetary and fiscal policy developments. Du and Wei spoke with the IMF Survey about their findings.

IMF SURVEY: How do you define insider trading?

Surely, the criteria must vary across countries.

WEI: The general definition of insider trading is fairly clear. It refers to the trading of stocks by people who through their professional work have access to information that is relevant to the value of the company and, hence, the price of the stock. What is less clear is its precise boundary in practical applications.

The United States has arguably the most stringent regulations with regard to insider trading, and its definition of insider trading has evolved over time.

Traditionally, regulators in the U.S. viewed corporate officers—the chief executive officer, the chief financial officer, and other corporate officers—and major shareholders as insiders. This definition was expanded to include people who, through their professional

work, may have access to privileged information, such as a company's lawyers, accountants, or others who have certain information that the public does not. U.S. regulators expanded this definition further, still, to include people who have no professional association with a company but might, nonetheless, have access to privileged information. These insiders might, for example, be the spouse of a company officer, or someone working in a photocopy shop. The underlying concern is that they can also trade stocks based on this "inside" information. In most other countries, the definition of insider trading is considerably less broad.

IMF SURVEY: How do you measure the extent of insider trading?

DU: Our measurement makes use of the results of a survey conducted jointly by the World Economic Forum, which is a global network of corporations, and Harvard University's Center for International Development. Among other things, this survey asks corporate executives around the world to assess the degree of insider trading in financial markets in which they have had extensive experience. Because insider trading tends to be illegal, it is difficult to measure directly. It's similar to measuring corruption or other under-the-table activities. You must use perceptions to estimate the degree of insider trading; you cannot count the amount of money changing hands.



Julian Du



Shang-Jin Wei

Available on the web (www.imf.org)

Transcripts

Press Briefing by Managing Director Horst Köhler at the Burj Al Arab Hotel, Dubai, United Arab Emirates, June 6

Press Releases

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- 03/82: IMF Approves \$34 Million Three-Year PRGF Arrangement for Burkina Faso, June 11
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Public Information Notices

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- 03/66: IMF Concludes 2003 Article IV Consultation with Switzerland, June 2
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Speeches

"A Public-Private Partnership for Confidence-Building," Horst Köhler, Managing Director, IMF, Institute of International Finance, Berlin, June 4