Rationality in an Irrational Market

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Suppose you bought a case of good Bordeaux in the futures market for $20 a bottle. The wine now sells at auction for $75 per bottle. You have decided to drink a bottle.

Which of the following captures your feeling of the cost to you for drinking the bottle?

A) $0, I already paid for it

B) $20, what I paid for it

C) $20 plus interest

D) $75, what I could get if I sold the bottle

E) $55, I get to drink the bottle worth $75 that I only paid $20 for so I save money by drinking the bottle.

What is the correct answer according to economic theory?

According to economic theory the answer is $75 since the opportunity cost of drinking the wine is what it is selling for. A true econ/rational buyer would choose this answer and most all economic theory is based on this.
The above question was given to 170 professional economists.

Here are the results:

A) $0, I already paid for it
(30%)

B) $20, what I paid for it
(18%)

C) $20 plus interest

(7%)

D) $75 what I could get if I sold the bottle (20%)

E) $55, I get to drink a bottle that is worth $75 that I only paid $20 for so I save money by drinking the bottle. (25%)

Even most of the professional economists did not act according to rational economic thought!

Current Market Value is the price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts.

(Treasury Regulation sec 20.2031-1 [b])

Market Value is similar to Current Market Value except that the provision for lack of compulsion to buy and sell is removed and the assumption of a sale within a specified time frame is added.

The primary value assumptions are fraught with rationality issues.

What values really add value and they are not necessarily the same.

How to calculate transaction costs?

How do you determine if both parties are knowledgeable?

There can be cases of hidden compulsions to sell or buy.

The results are the prices in the marketplace are not a rational representation of the market.

The airplane market makes a few of the assumptions that traditional economic theory is based on and the results are valuations that can be widely divergent.

The back to back market exists in large part to middlemen taking advantage of these market inefficiencies.

If the market was truly efficient as economic theory suggests, there would not be an opportunity to make a market by doing a back to back.

If the transaction costs in a back to back are within reasonable and normal ranges, then the buyer and seller will most likely not have an issue when they find out. HOWEVER, when the fees for a small transaction risk far exceed the norms, then the market becomes distorted.

Seller is told he is getting a fair market price for his aircraft. The buyer is being told he is getting a fair price for the aircraft. However the transaction costs are well outside the normal range.

What is the real market price? One aircraft results in two different market prices.

In theory, this can not happen. Were both parties knowledgeable?

Irrationality exists in all markets. It is more predominate in low volume markets with lots of valuation variables.

The aircraft market is a prime example of human behavior rather than pure economic theory effecting market values. Non-rational actions impact prices.

Once you accept the irrational behavior you will better understand the variances in the market.

The more the market place is represented by knowledgeable buyers and sellers with professional assistance, the more accurate the valuations will be.