To dampen the trading frenzy in the stock market, the Chinese government tripled the stamp tax for stock trading on May 30, 2007. Interestingly, the largely increased trading cost caused trading frenzy to migrate from the stock market to the warrant market, which was not subject to the stamp tax, exacerbating a spectacular price bubble in a set of deep out-of-the-money put warrants. This episode highlights the so-called “Whack-A-Mole” game in financial regulations - when a policy is instituted to whack down frenzy or turmoil in one market, it may crop up in other unregulated markets. The paper is a joint work with Jinghan Cai (Scranton), Jibao He (Shenzhen Stock Exchange) and Wei Xiong (Princeton).

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