Nicholas Lyle

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On the Impossibility of Informationally Efficient Market

Grossman, Stiglitz

Grossman and Stiglitz in this paper are talking about how it is impossible for markets to have all of the information available represented in the price of something. If prices had all of the information built into them then there would be no arbitrage because prices would be perfectly efficient. Grossman and Stiglitz are saying that there is no way for this to happen because there is a cost to the information to know about the arbitrage which will keep people from using all of their time and money to learn all of this information. They are also saying that the inefficiencies in the market are a way to compensate investors for gathering information. They mention the comparative statics in their model which are: an increase in the quality of the information increases the informativness of the price system, a decrease in the cost of information increases the informativness of the price system, a decrease in risk aversion increases informativness in the price system and an increase in noise increases the proportion of informed traders. Noise refers to random price signals I believe.