ON THE POSSIBILITY OF INFORMATIONALLY EFFICIENT MARKETS

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Abstract
This paper presents conditions for a resolution of the Grossman-Stiglitz paradox of informationally efficient markets. We display a market with asymmetric information where a privately revealing equilibrium obtains in a competitive framework and where incentives to acquire information are preserved as long as the correlation in traders’ valuations is not too large. The equilibrium is efficient, and the problems associated with fully revealing rational expectations equilibria are precluded without resorting necessarily to noise traders. The robustness of the results to general information structures is established and the effect of market power is examined in a large market approximation to the competitive economy. The model is applied to explain changes in bidding behavior in central bank liquidity auctions in the crisis period. (JEL: D82, D84, G14, E59)

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