Can Additional Information really have Negative Welfare Effects : Reply

by Kenneth J. Arrow *

Mr. Breyer's comments is of course formally correct. Indeed the observation was already made in my paper on page 15, second paragraph from the bottom. Following Hirshleifer I had noted that the existence of public information destroys the possibility of contingent claims markets and thereby prevents an efficient allocation of risk bearing (to avoid misunderstanding, the extreme statements are valid only in my example, where public information is perfect ; if the public information is imperfect, it is still true that a fully efficient allocation of risks cannot be reached, but there might still be some contingent claims market). Breyer notices that if one could create a new market, this time contingent on the information rather than on the event itself, then full efficiency can be achieved.

If such markets were possible, then indeed the argument would be correct. Obviously the point of the story is that markets contingent on information are much *less likely to be viable than markets* contingent on *actual* observed events. A contingent market requires for its existence that the event on which it is contingent be *publically* verifiable. A prediction of weather is clearly not such a verifiable event as the weather itself. It is for this reason that I think the Hirshleifer argument is a basically important one.

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