Peer Review

Review of: "A Philosophical Paradox of Economic Theory"

Lutz G. Arnold[1]

1. Universität Regensburg, Germany

The author's main argument is: people with perfect economic models can make unbounded profits. Real economies must not leave scope for unbounded profits. So perfect economic models cannot exist.

The arguments, if I interpret them correctly, mix up models and reality. Anyway, the conclusions are based on two fallacies.

1. They do not apply to models without uncertainty. They have no bearing on the standard Walrasian model or any other theory without uncertainty.
2. “Perfect predictions” is interpreted as: knowledge of the future state of the world. If agents know the future state of the world, there is no uncertainty, and the previous remark applies.

Even if there is uncertainty, economic theory works perfectly fine. No arbitrage, the most fundamental idea in asset pricing (as noted by the author), means that people cannot make unbounded profits *with certainty*. This is, of course, not contradicted by the observation that some people get rich. Given uncertainty, things could have turned out differently. There is also much literature on differential information and limits of arbitrage.

The fact that the author cites the job market signalling model as a motivation to teach economics and finance is odd. This theory is based on incomplete information (employers do not know nature's draws of workers' types) and yields an equilibrium with no unbounded profits. This example is enough to falsify the main claim of the paper.

Declarations

Potential competing interests: No potential competing interests to declare.