Deliberate Limits to Arbitrage

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Abstract

This paper develops a model in which arbitrageurs are collectively unconstrained, but may still prefer to incur individual limits to arbitrage rather than make full use of their combined resources. These deliberate limits arise because the communication of an arbitrage position reveals the underlying idea, which creates future competition in the absence of relevant property rights. We allow arbitrage opportunities to vary along two dimensions: the ease with which they can be identified and the speed at which they mature. We find that deliberate limits to arbitrage arise for opportunities in the mid-range of the maturity dimension. This range widens when the opportunities are easier to find. Our results thus offer a set of theoretical predictions about the arbitrage trades that are likely to exist in the market.

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