What are Perfect Capital Markets?

Various presentations of perfect capital markets are available, with different versions emphasizing elements which are of importance to the argument at hand. One particularly complete set is provided in Haley and Schall (1979).

A.1 **Costless capital markets**: No capital market transactions costs (including commissions and bid/offer spreads), no government restrictions which interfere with capital market transactions, and the costless ability to make financial assets infinitely divisible.

A.2 **Neutral Taxes**: There are no personal or corporate taxes.

A.3 **Competitive Markets**: There are many perfect substitutes for all securities of a firm at any point in time and there is no discrimination in the pricing of these securities such that any security can be acquired at the same market price by all investors. In addition, firms and investors are price takers in investing, borrowing and lending activities.

A.4 **Equal Access**: Investors and firms can borrow, lend and issue claims on the same terms. This assumption requires that borrowing and lending rates be equal.

A.5 **Homogeneous Expectations**: All capital market participants have the same expectations about relevant random variables.

A.6 **No Information Costs**: Firms and individuals have the same available information and this information is acquired at zero cost.

A.7 **No Costs of Financial Distress**: Firms and individuals incur no costs of financial distress or bankruptcy such as legal costs and disruption of operations. This assumption does not rule out the possibility of bankruptcy.