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# The Arbitrage Principle in Financial Economics

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### Abstract

The importance of arbitrage conditions in financial economics has been recognized since Modigliani and Miller's classic work on the financial structure of the firm. They showed that if a firm could change its market value by purely financial operations such as adjusting its debt-equity ratio, then individual shareholders and bondholders could engage in analogous portfolio transactions that would yield pure arbitrage profits. If the market was efficient enough to eliminate arbitrage profits for the individual shareholders, then it would eliminate arbitrage profits for the firm as well.

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hypothesis of no arbitrage, and it serves as one of the most basic unifying

principles of the study of financial markets. In this essay we will examine some of these results.

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