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A dynamic model of equilibrium selection in signaling markets

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In his work on signaling, Spence proposed a dynamic model of a market in which a buyer revises prices in light of experience and in which sellers, with private information about their types, choose utility-maximizing signals given these prices. We follow Spence's suggestion of introducing perturbations into the resulting dynamic process. In a broad class of markets, our model selects a separating equilibrium outcome if and only if the equilibrium outcome satisfies a version of the undefeated equilibrium concept, whereas a pooling equilibrium outcome is selected if and only if the equilibrium outcome is both undefeated and satisfies $D1$.

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