

Economics 211, Macroeconomic elective

Spring 2003

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Thursday, 8:00-11:00

Room: Sequoyah 244

The course will build upon the topics you studied and the tools you acquired in the first year courses. Most of the previous paradigms presented were based on Representative Agent models. An important goal of this last quarter is to study macroeconomic models with Heterogeneous Agents. In particular, we study models in which agents are unable to perfectly insure against idiosyncratic risks. After reviewing the basic model with complete markets, we start analyzing environments in which market incompleteness is taken as a given and agents can insure themselves only by accumulating fixed return assets. Beginning with this class of models, we consider theoretical frameworks in which market incompleteness derives endogenously due to limited enforceability or asymmetric information. We study the optimal and incentive compatible allocations in the presence of these agency problems. We also investigate the incentive problem in models in which agency problems depend on investment, as in the case of entrepreneurs. As part of the assignments, students are asked to replicate some of the numerical results of the papers discussed in class. The plan is to cover in depth a few basic papers that are useful from a methodological point of view. Once we understand these papers, we can understand a large range of more complex contributions that can be analyzed with similar methodological tools.

Grading Policy: Problem sets: 40%; Final Exam: 60%

Reading materials: We will use some chapters from *Recursive Macroeconomic Theory*, of Ljungqvist and Sargent, and additional articles listed below.

Program

I – Competitive equilibrium with complete markets

The complete market model is the basic framework we will depart from during the course. Before doing this, however, it is important to review the basic concepts.

Ljungqvist, L. and Sargent, T.J. (2000), “Recursive Macroeconomic Theory”, Chapters 6 and 7.

II – Incomplete markets: Uninsurable endowment risks

Ljungqvist, L. and Sargent, T.J. (2000), “Recursive Macroeconomic Theory”, Chapter 14.

Imrohoroglu, A. (1989). Cost of Business Cycles With Indivisibilities and Liquidity Constraints. *Journal of Political Economy*, 97 (6), 1364-83.

Ayiagari, R. (1994). Uninsured Idiosyncratic Risk and Aggregate Savings. *Quarterly Journal of Economics*, 59(3), 659-84.

Krusell, P. and Smith. A. (1998). Income and Wealth Heterogeneity in Macroeconomic. *Journal of Political Economy*, 106(5), 867-96.

III – Incomplete markets: Endowment risks and limited enforceability

Ljungqvist, L. and Sargent, T.J. (2000), “Recursive Macroeconomic Theory”, Chapter 15.

Kockerlacota, N.R. (1996). Implications of Efficient Risk Sharing without Commitment. *Review of Economic Studies*., 63(4), 595-609.

IV – Incomplete markets: Unobservable endowment risks

Ljungqvist, L. and Sargent, T.J. (2000), “Recursive Macroeconomic Theory”, Chapter 15.

Atkeson, A. & Lucas, R. E. (1992). On efficient distribution with private information. *Review of Economic Studies*, 59 (4), 427–53.

V – Incomplete markets: Production risks and limited enforceability

Marcet, A. & Marimon, R. (1992). Communication, commitment and growth. *Journal of Economic Theory*, 58 (1), 219–249.

Cooley, T. and Marimon, R. and Quadrini, V. (1999). Aggregate consequences of limited contract enforceability. Unpublished manuscript.

VI – Incomplete markets: Unobservable production risks

Ljungqvist, L. and Sargent, T.J. (2000), “Recursive Macroeconomic Theory”, Chapter 15.

Khan, A. and Ravikumar, B. (2001). Growth and risk sharing with private information. *Journal of Monetary Economics*, 32, 513-42.

Quadrini, V. (2001). Entrepreneurial Investment and Default in Optimal Contracts with repeated moral hazard. Unpublished manuscript.

VII – Search, matching and unemployment

Ljungqvist, L. and Sargent, T.J. (2000), “Recursive Macroeconomic Theory”, Chapters 5 and 19.