

September 3

Workshop

September 3,4 – 2007

Manufacture des Tabacs – Aile JJ Laffont – MF 323

« The Theory and Empirics of Risk Sharing »

Organized by Pierre Dubois, Bruno Jullien and Thierry Magnac

PROGRAM

14h00 – 15h30 Sam Schulhofer-Wohl – Princeton University

« Hétérogénéité, risk sharing and the welfare costs of risk »

How well do people share risk? Do non-market institutions – charity, progressive taxes, transfer payments – make up for the lack of complete insurance markets? Or is risk sharing far worse than what complete markets could achieve? Standard risk-sharing regressions assume that any variation in households' risk preferences is uncorrelated with variation in income. I combine administrative and survey data with a simple model of imperfect insurance to show that this assumption fails; risk-tolerant workers sort into jobs where earnings carry more aggregate risk. The correlation makes previous risk-sharing regressions too pessimistic. I derive techniques that eliminate the bias, apply them to U.S. data, and find that the welfare losses from uninsured shocks are practically small and statistically difficult to distinguish from zero. In addition, because more risk-tolerant people bear more aggregate risk, the welfare costs of macroeconomic fluctuations are small even for arbitrarily risk-averse households. There is little room to improve households' welfare by smoothing idiosyncratic or aggregate shocks unless smoothing shocks also allows households to choose more productive occupations.

15h30 – 16h00 Coffee break – MF 322

16h00 – 17h30 Tim Worall – University of Keele

« Limited commitment models of the labour market » with Jonathan P. Thomas

We present an overview of models of self-enforcing labour contracts in which risk-sharing is the dominant motive for contractual solutions. A base model is developed which is sufficiently general to encompass the two-agent problem central to most of the literature. We consider two-sided limited commitment and look at its implications for macroeconomics; we then consider what empirical support exists for the model. We also consider the one-sided limited commitment problem for which there exists a considerable amount of empirical testing.

Keywords: Labour contracts, self-enforcing contracts, business cycle, unemployment.

JEL-Codes: E32, J41.

September 4

9h30 – 11h00 Thomas Mariotti – GREMAQ – IDEI

« Accident risk, limited liability and dynamic moral hazard » with B. Biais, JJ. Charles Rochet, S. Villeneuve

A firm is subject to accident risk, which the manager can mitigate by exerting effort. An agency problem arises because effort is unobservable and the manager has limited liability. The occurrence of accidents is modelled as a Poisson process, whose intensity is controlled by the manager. We use martingale techniques to formulate the manager's incentive compatibility constraints and to study the optimal contract. The latter is characterized by a differential equation with delay. The manager receives cash transfers only if no accident occurs during a sufficiently long period of time, while the firm is downsized if accidents are too frequent. This can be implemented by cash reserves, along with insurance, financial, and compensation contracts. The insurance contract involves a deductible and a bonus-penalty system. The financial contract consists of bonds that pay constant coupons until the firm enters financial distress. Covenants request that the firm be downsized when its liquidity ratio falls below a threshold. The manager's compensation policy promises incentive wages when the accumulated performance of the firm is high enough. Our theoretical analysis also delivers new empirical implications about the dynamics of insurance premia and credit yield spreads.

11h00 – 11h15 Coffee break – MF 322

11h15 – 12h45 Yuliy Sannikov – University of California at Berkeley

«A Learning Model of Dividend Smoothing. » with Peter de Marzo

We derive the optimal dynamic contract in a continuous-time principal-agent setting, in which both investors and the agent learn about the firm's profitability over time. We show that the optimal contract can be implemented through the firm's payout policy. The firm accumulates cash until it reaches a target balance that depends on the agent's perceived productivity. Once this target balance is reached, the firm starts paying dividends equal to its expected future earnings, while any temporary shocks to earnings either add to or deplete the firm's cash reserves. The firm is liquidated if its cash reserves fall below a minimum threshold. We also show that once the firm initiates dividends, this liquidation policy is first-best, despite the agency problem.

12h45 – 14h00 Lunch – ME 001 – (Bâtiment E)

14h00 – 15h30 Maurizio Mazzocco – University of California

« Testing efficient risk sharing with heterogeneous risk preferences: Semi-parametric tests with an application to village economies » with Shiv Saini University of Wisconsin

Previous papers have tested efficient risk sharing under the assumption of identical risk preferences. In this paper we show that, if in the data households have heterogeneous risk preferences, the tests proposed in the past reject efficiency even if households share risk efficiently. To address this issue we propose a method that enables one to test efficiency even when households have different preferences for risk. The method is composed of three tests. The first one can be used to determine whether in the data under investigation households have homogeneous risk preferences. The second and third test can be used to evaluate efficient risk sharing when the hypothesis of homogeneous risk preferences is rejected. We use this method to test efficient risk sharing in rural India. Using the first test, we strongly reject the hypothesis of identical risk preferences. We then test efficiency with and without the assumption of preference homogeneity. In the first case we reject efficient risk sharing at the village and caste level. In the second case we still reject efficiency at the village level, but we cannot reject this hypothesis at the caste level. This finding suggests that the relevant risk-sharing unit in rural India is the caste and not the village.

15h30 Coffee Break – MF 322

