### 14.462 Advanced Macroeconomics / 14.129 Advanced Contract Theory

**Spring 2013**

**Lectures:**  
Tuesday 1-2:30 (E51-361)  
Thursday 1-4 (E51-361)

**Recitations:** Friday 1-2:30 (E51-361)

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**TA:** Amir Kermani, kermani@mit.edu

**Contents:** The course shows how contract and general equilibrium theory can help our understanding of the functioning of financial markets, the occurrence of crises, and to evaluate the rationale for financial regulation. In particular, it emphasizes that identifying the nature of financial frictions is crucial to determining potential market failures – we will see many instances in which markets achieve on their own constrained-optimal outcomes. We will then move to micro-foundations of limited trade, such as separation in time and space, to address the role of circulating private debt, fiat money, notions of liquidity, and optimal monetary policy.

**Requirements:** The grade will be based on class participation, problem sets, and a research proposal. The problem sets will cover theoretical problems related to papers discussed in the class. The proposal should consist of a research strategy to address questions that came up during the class. Ideally such proposal could lead to a third year paper. There is an additional class on Tuesday April 30 evening that is reserved for student presentations followed by a discussion of the proposals.

**Readings:** Most readings can be reached through the links on the stellar website. Please inform the TA of any broken links. You may need to be on campus to access links to copy-written materials (e.g. NBER working papers, JSTOR). Readings that are not available online will be available via library reserve.
## Schedule of lectures

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<td>Introduction</td>
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<td>Foundations of General Equilibrium. Walrasian vs explicit markets with price formation, all in basic environments without imperfections.</td>
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<td>4-Apr</td>
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<td>Decentralization, explicit competition, and markets with limited information as an obstacle to trade.</td>
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<td>5-Apr</td>
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<td>Guerrieri, Shimer and Wright (2010)</td>
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<td>Money, monetary policy, real bills vs quantity theory</td>
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<td>25-Apr</td>
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<td>Thursday</td>
<td>Private money, limited participation, and the value of named traders</td>
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<td>26-Apr</td>
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<td>Caballero and Krishnamurthy (2006)</td>
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<td>30-Apr</td>
<td>12</td>
<td>Tuesday</td>
<td>Money and liquidity, inventory, payment systems</td>
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<td>30-Apr</td>
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<td>Tuesday</td>
<td>Research proposal presentation by students</td>
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<td>2-May</td>
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<td>Thursday</td>
<td>Lester, Postlewaite and Wright (2006)</td>
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(1) April 2 (Tuesday) Introduction

Current financial market regulation topics. How markets and institutions are put together, how they actually function, viewed through the lens of theories with obstacles to trade.

Past
• Bagehot, W., 1873. *Lombard Street: A Description of the Money Market*

Present: in the US

Present: in developing countries
• Sripakdeevong, P. and Townsend, R. 2012. Bridge Loans, the Village Money Market, and Risk Sharing, mimeo MIT

Future

Prudential regulation debate

(2) April 4 (Thursday part 1) Foundations of General Equilibrium. Walrasian vs explicit markets with price formation, all in basic environments without imperfections.


See also

- MWG Section 18.C

(3) April 4 (Thursday part 2) Decentralization, explicit competition, and markets with limited information as an obstacle to trade.


Related Literature


Recitation 1


(4) April 9 (Tuesday) Welfare theorems and pricing with limited commitment


Related Literature

(5) April 11 (Thursday Part 1) Bank runs and retraining


Related Literature


(5) April 11 (Thursday part 2) Pecuniary externalities and interconnectedness


**Recitation 2**


(6) April 18 (Thursday part 1) General equilibrium with incomplete markets and risk of default


Related Literature


• Handout for Case-Shiller-Index

• Handouts for Cat Bonds and Reinsurance

(7) April 18 (Thursday part 2) Implementation and regulation, ex-ante vs. ex-post competition


Related Literature


Recitation 3

(8) April 23 (Tuesday) Bubbles with limited markets and limited participation

Related Literature:

(9) April 25 (Thursday Part 1) Money, monetary policy, real bills vs quantity theory

Related Literature:

(11) April 25 (Thursday Part 2): Private money, limited participation, and the value of named traders

• Chandrasekhar, Townsend, Xandri

Related Literature:

• R. Caballero, A Simsek, “Fire sales in a model of complexity”

Recitation 4


(12) April 30 (Tuesday) Money and liquidity, inventory, payment systems

Part 1: Demand for cash


Related literature

• Alvarez, F., Pawasutipaisit, A. & Townsend, R.M., 2011. Household as Firms: Cash Management in Thai Villages. mimeo University of Chicago

Part 2: Payments and clearing


Related literature

• Warren Weber, Clearing Arrangements in the United States Before the Fed

### Part 3: Search


### Related literature


### Recitation 5