

14.462 Advanced Macroeconomics / 14.129 Advanced Contract Theory  
Spring 2011

Lectures: TTH 1 – 2:30 in E52-361  
Reciations: F 1-2:30 in E52-361

Instructors: Robert Townsend, [rtownsen@mit.edu](mailto:rtownsen@mit.edu)

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Contents:

The course will bring together contract theory and general equilibrium to focus on what fundamental and recent literature has to tell us about financial structures, motivated by the recent problems in financial markets and institutions. We will examine the role of banks, financial intermediation and market design, first in Walrasian worlds, and then when there is costly state verification, moral hazard and/or adverse selection. We will then moves 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:

There will be a final exam. There will also be two problem sets for the class. One problem set will cover theoretical problems related to papers discussed in the class. The second problem set will consist of a research proposal based on the covered material. The proposal should consist of a research strategy to adress questions that came up during the class. Ideally such proposal could lead to a third year paper. We will discuss some of the proposals during the last lecture of the class. We plan to have three or four students presenting their proposals. So if you like to present your ideas to get feedback, please let the TAs know. The final grade will be determined by the problem sets, the final exam and class participation.

Readings:

Most readings can be reached through the s 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:

(1) March 29: Introduction and Jacklin C., (1984), "Demand deposits, trade restrictions and risk sharing"

(2) March 31: Prescott E., Robert M. Townsend, "General Competitive Analysis in an Economy with Private Information, International Economic Review, Vol. 25, No. 1 (Feb., 1984), pp. 1-20.

*Recitation, April 1: Exam for Darons part*

(3) April 5: F Allen, D Gale, (2004), "Financial intermediaries and markets", *Econometrica*.

(4) April 7: Kilenthong, T. and R. M. Townsend (2009): "Market Based, Segregated Exchanges in Securities with Default Risk", Working Paper

*Recitation, April 8: A Theory of Liquidity and Regulation of Financial Intermediation (with E. Farhi and M. Golosov), Review of Economic Studies (2009), 76(3): 973-992*

(5) April 12 Kilenthong, Weerachart T. and Robert M. Townsend (2010) "Information-Constrained Optima with Retrading: An Externality and Its Market-Based Solution", *Journal of Economic Theory*

(6) April 14 Pesendorfer W. (1995), "Financial Innovation in a General Equilibrium Model", *Journal of Economic Theory*

*Recitation, April 15: Douglas Diamond, "Financial intermediation and delegated monitoring", Review of Economic Studies 1984*

April 19 PATRIOTS DAY

(7) April 21 Bond, Philip (2004), "Bank and nonbank financial intermediation", *The Journal of Finance*

*Recitation, April 22: Calomiris, Kahn (1991) AER, The role of demandable debt in structuring optimal banking arrangements .*

(8) April 26 Banks and Bank Regulation: Discussion of

- Diamond and Rajan, A Theory of Bank Capital (2000)
- Marshall and Prescott, State-contingent Bank Regulation with Unobserved Actions and Unobserved Characteristics (2005)
- Matutes and Vives, Competition for Deposits, Fragility, and Insurance (1996)
- Dewatripont and Tirole, The Prudential Regulation of Banks (1994), Chapters 7-10.

(9) April 28 Townsend, Robert M., (1980) "Models of Money with Spatially Separated Agents", In: *Models of Monetary Economies*, ed. by J. H. Kareken and Neil Wallace, Minneapolis: Federal Reserve Bank of Minneapolis, pp. 265--304.

*Recitation, April 29: Ljungqvist L., Thomas J. Sargent, (2004) Recursive Macroeconomic Theory, Chapter 25*

(10) May 3 Manuelli, Rodolfo and Thomas J. Sargent (2009) "Alternative Monetary Policies in a Turnpike Economy: Vintage Article," Mimeo

(11) May 5 R Townsend, N Wallace, "Circulating Private Debt: An Example with Coordination Problem," in *Contractual Arrangements for Intertemporal Trade*, 1987.

*Recitation, May 6: TBD*

(12) May 10

- Townsend, Robert (1989) "Currency and Credit in a Private Information Economy." *Journal of Political Economy*, 97, no. 6 (December 1989): 1323-1345
- William Jack, Robert Townsend and Tavneet Suri, "Monetary Theory and Electronic Money: Reflections on the Kenyan Experience," *Economic Quarterly* 96(1): 83-122.
- Green, Edward J. 1999. "Money and Debt in the Structure of Payments." *Federal Reserve Bank of Minneapolis Quarterly Review* 23 (Spring):13–29.
- Freeman, Scott. 1996. "The Payments System, Liquidity, and Rediscounting." *American Economic Review* 86 (December): 1,126–38.
- Townsend, Robert. 1983. "Financial Structure and Economic Activity." *American Economic Review* 73 (December): 895–911.
- Townsend, Robert. 1987. "Economic Organization with Limited Communication." *American Economic Review* 77 (December): 954–71.

(13) May 12 Discussion of research proposals and general discussion