

Finance 923

Spring 2023

Course Outline and Readings

Richard Kihlstrom

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1. Information Basics

(a) The value of information

i. Expected Utility Models

Papers

D. Blackwell, "The Comparison of Experiments", *Proceedings of the Second Berkeley Symposium on Mathematical Statistics and Probability*, University of California Press, (1951), 93-102.

*D. Blackwell, "Equivalent Comparisons of Experiments", *Annals of Mathematical Statistics*, (June, 1953), 265-72.

R. Kihlstrom, "A Bayesian Exposition of Blackwell's Theorem on the Comparison of Experiments", in M. Boyer and R. Kihlstrom, editors, *Bayesian Models in Economic Theory*, (1984), 13-31.

Gollier, C. 2001. Chapter 24, *The Economics of Risk and Time*, MIT Press

*R. Kihlstrom, "Risk Aversion and the Value of Information: A Selective Survey" Chapter 111, *Encyclopedia of Finance*, C.F. Lee and Alice Lee, editors, Springer Nature, (2022)

*Cabral, A., O. Gossner and R. Serrano, "Entropy and the Value of Information for Investors," *American Economic Review*, (2013) 360-77.

ii. Kreps-Porteus and Epstein-Zin, Weil Preferences

Papers

*Selden, L., "A New Representation of Preferences over 'Certain x Uncertain' Consumption Pairs: The 'Ordinal Certainty Equivalent' Hypothesis," *Econometrica*, 46 (1978) 1045-60

*Kreps, David and Evan Porteus, "Temporal Resolution of Uncertainty and Dynamic Choice Theory," *Econometrica*, 46, (1978) 185-200

*Epstein, L., and S. Zin, "Substitution, Risk Aversion and the Temporal Behavior of Consumption and Asset Returns: A Theoretical Framework," *Econometrica*, 57 (1989), 937-69

*Weil, P., "The Equity Premium Puzzle and the Risk Free Rate Puzzle," *Journal of Monetary Economics*, 24 (1989), 401-21.

iii. The Social Value of Information

Papers

- *J. Hirschleifer, "The Private and Social Value of Information", *American Economic Review*, 61, (1971), 561-74.
 P. Milgrom and N. Stokey, "Information, Trade and Common Knowledge," *Journal of Economic Theory*, 26, (1982), 17-27.

(b) Generalities

Paper

- M. Jensen and W. Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure", *Journal of Financial Economics*, 3, (Oct., 1976), 305-60

2. Rational Expectations

Papers

- *R. Lucas, "Expectations and the Neutrality of Money," *Journal of Economic Theory*, 4, (1972), 103-24.
 *D. Kreps, "A Note on Fulfilled Expectations Equilibria", *Journal of Economic Theory*, 14, (1977), 32-44.
 S. Grossman, "The Existence of Futures Markets, Noisy Rational Expectation and Informational Externalities", *The Review of Economic Studies*, 44, (1977), 431-49.
 *S. Grossman, "On the Efficiency of Competitive Stock Markets where Traders Have Diverse Information", *Journal of Finance*, 31, (1976), 573-85.
 S. Grossman and J. Stiglitz, "On the Impossibility of Informationally Efficient Markets", *American Economic Review* 70, (1980), 393-408.
 John Y. Campbell and Albert S. Kyle, "Smart Money, Noise Trading and Stock Price Behaviour," *The Review of Economic Studies*, 60, (Jan., 1993) 1-34
 J. Wang, "A Model of Intertemporal Asset Prices Under Asymmetric Information," *Review of Economic Studies*, 60, (1993) 249-282.
 *Martin Hellwig, "On the Aggregation of Information in Competitive Markets." *Journal of Economic Theory*, 22 (1980) 477-98
 *A. Kyle, "Continuous Auctions and Insider Trading", *Econometrica*, 53 (Nov., 1985), 1315-35.
 *A. Kyle, "Informed Speculation with Imperfect Competition", *Review of Economic Studies*, 56 (1989) 317-55.

3. Adverse Selection and Signaling Equilibria

Papers

- *M. Rothschild and J. Stiglitz, "Equilibrium in Competitive Insurance Markets: An Essay on the Economics of Imperfect Information", *Quarterly Journal of Economics*, 90, (1976) 629-50.
 *J. Stiglitz, "Monopoly, Non-linear Pricing, and Imperfect Information: The Insurance Market," *Review of Economic Studies*, 44, (Oct., 1977) 407-430.
 S. Ross, "The Determination of Financial Structure: the Incentive Signaling Approach", *Bell Journal of Economics and Management Science*, 8, (Spring, 1977) 23-40.

*H. Leland and D. Pyle, "Information Asymmetries, Financial Structure and Financial Intermediation", *Journal of Finance*, 32, (May, 1977), 737-48.

S. Myers and N. Majluf, "Corporate Financing and Investment Decisions when Firms Have Information that Investors Do Not Have", *Journal of Financial Economics*, 13, (June, 1984), 187-221.

*Chakrabarty, A., and B. Yilmaz, "Adverse Selection and Convertible Bonds," (2009) *Review of Economic Studies*.

K. Rock, "Why New Issues Are Underpriced", *Journal of Financial Economics*, 14 (Mar., 1986) 187-212.

*P. DeMarzo and D. Duffie, "A Liquidity Based Model of Security Design," *Econometrica*, 67 (1999) 65-99.

*P. DeMarzo, "The Pooling and Tranching of Securities," *Review of Financial Studies*, 18 (2005) 1-35.

J. Stiglitz and A. Weiss, "Credit Rationing in Markets with Imperfect Information," *American Economic Review*, 71 (1981) 393-410.

Douglas W. Diamond, "Reputation Acquisition in Debt Markets" *The Journal of Political Economy*, 97, (Aug., 1989), 828-862.

4. Moral Hazard, Managerial Incentives and "Bonding" Equilibria

Papers

*S. Grossman and O. Hart, "Corporate Financial Structure and Managerial Incentives", in J. McCall, editor, *The Economics of Information and Uncertainty*, University of Chicago Press: Chicago, (1982), 107-37.

Jeffrey Zwiebel, "Dynamic Capital Structure under Managerial Entrenchment," *The American Economic Review*, 86, (Dec., 1996), 1197-1215.

M. Jensen, "Agency Costs of Free Cash Flow, Corporate Finance and Takeovers," *American Economic Review*, 76 (1986) 323-9.

5. Dynamic Models with Asymmetric Information

Papers

William P. Rogerson, "Repeated Moral Hazard," *Econometrica*, 53, (Jan., 1985), 69-76.

Spear, S., and S. Srivastava, "On Repeated Moral Hazard with Discounting," *Review of Economic Studies*, 54, (1987), 599-617.

Holmstrom, B. and P. Milgrom, "Aggregation and Linearity in the Provision of Intertemporal Incentives," *Econometrica*, 55, (Jan., 1987), 303-28

Albuquerque, R. and Hopenhayn, H. A. "Optimal Lending Contracts and Firm Dynamics," *Review of Economic Studies*, 72, (2004), 285-315.

Clementi, G. L. and Hopenhayn, H. A. "A Theory of Financing Contracts and Firm Dynamics," *Quarterly Journal of Economics*, 121, (2006), 229-265.

P. DeMarzo and M. Fishman, "Optimal Long-Term Financial Contracting," *Review of Financial Studies*, 20, (2007), 2079-2128.

P. DeMarzo and M. Fishman, "Agency and Optimal Investment Dynamics," *Review of Financial Studies*, 20, (2007), 152-188.

DeMarzo, P. and Y. Sannikov "Optimal Security Design and Dynamic Capital Structure in a Continuous-Time Agency Model," *Journal of Finance*, 61, (2006) 2681-2724.

Sannikov, Y., "A Continuous-Time Version of The Principal-Agent Problem," *Review of Economic Studies*, 75, (2008), 957-984.

6. Auctions

Papers

W. Vickrey, "Counterspeculation, Auctions and Competitive, Sealed Tenders", *Journal of Finance*, 16, (1961), 8-37.

R. Wilson, "A Bidding Model of Perfect Competition", *Review of Economic Studies*, 44, (1977), 511-8.

S. Matthews, "Information Acquisition in Discriminatory Auctions", in Boyer and R. Kihlstrom, editors, *Bayesian Models in Economic Theory*, (1984).

S. Matthews, "A Technical Primer on Auction Theory I: Independent Private Values", Unpublished Lecture Notes, (1995).

P. Milgrom and R. Weber, "A Theory of Auctions and Competitive Bidding", *Econometrica*, 50, (Sept., 1982), 1089-122.

J. Riley and W. Samuelson, "Optimal Auctions", *American Economic Review*, 71, (June, 1981), 381-92.

*R. Myerson, "Optimal Auction Design", *Mathematics of Operations Research*, 6, 58-73.

M. Harris and A. Raviv, "A Theory of Monopoly Pricing Schemes with Demand Uncertainty", *American Economic Review*, 71, (June, 1981), 347-6.

V. Krishna, *Auction Theory*, Academic Press, San Diego, 2002.

G. Jehle and P. Reny, *Advanced Microeconomic Theory*, Second Edition, Chapter 9, "Auctions and Mechanism Design," Addison Wesley Longman, New York, 2001.

W. Pesendorfer and J. Swinkels, "The Loser's Curse and Information Aggregation in Common Value Auctions," *Econometrica*, 65 (1997) 1247-82.

M. Jackson and I. Kremer, "On the Informational Efficiency of Discriminatory Price Auctions," *Journal of Economic Theory*,

*P. DeMarzo, I. Kremer and A. Skrzypacz, "Bidding with Securities: Auctions and Security Design," *American Economic Review*, forthcoming.

P. Povel and R. Singh, "Stapled Finance," *Journal of Finance*, (June, 2010), 927-53.

7. Recent Papers in Information in Financial Markets

Papers

Duffie, Darrell, Nicolae Garleanu, and Lasse Pedersen, "Over-the-Counter Markets." *Econometrica*, 73, (2005), 1815-1847.

Duffie, Darrell, Nicolae Garleanu, and Lasse Pedersen, "Valuation in Over-the-Counter Markets." *Review of Financial Studies*, 20, (2007), 1865-1900.

Duffie, Darrell, Semyon Malamud, and Gustavo Manso, "Information Percolation with Equilibrium Search Dynamics," *Econometrica*, 77, (2009), 1513-1574.

*Duffie, Darrell, Semyon Malamud, and Gustavo Manso, "Information Percolation in Segmented Markets," *Journal of Economic Theory*, 157, (2015), 1130-58.

B. Homstrom and J. Tirole, "Private and Public Supply of Liquidity," *Journal of Political Economy*, 106, (1998) 1-40.

O. Hart and L. Zingales, "Liquidity and Inefficient Investment," *Journal of the European Economic Association* 13 (5): (2015) 737-769.