

Partial List of Current Projects

P Dybvig

Wash U Brown Bag, 9/12/2007

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Theoretical Corporate

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Renegotiation-proof Contracting, Disclosure, and Incentives for Efficient Investment, joint with Nina Baranchuk (University of Texas-Dallas) and Jun Yang (Indiana University). This paper looks at optimal disclosure regulation in a setting requiring renegotiation-proofness. Announcing just the agreed-upon contract does not resolve the Myers-Majluf problem, because this outcome can be manipulated by the old shareholders' representatives. Announcing the entire negotiation process is not reasonable but would resolve the problem. Allowing the manager to make a forward-looking announcement resolves the Myers-Majluf problem, provided there is in place an optimal contract that induces the manager to reveal an accurate assessment of the prospects of the firm.

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Theoretical Corporate

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Consensus in Diverse Corporate Boards, with Nina Baranchuk (University of Texas-Dallas) uses a new cooperative solution concept, consensus, to analyze board decision-making. Consensus, the new solution concept we introduce, is motivated by a fallback to majority rule (in contrast to the fallback to a disagreement point in the Nash Bargaining solution). For example, if all but one board member agrees on a decision, agreement by the sole dissenter is not needed and the others will get their way. The solution concept is used to consider policy questions such as the possible value of conflicted but informed outside directors (and implicitly the optimal definition of independence) and the desirability of a supermajority of external directors.

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Empirical Corporate

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Money Grab in China, joint with Yingxue Cao (Tsinghua University) and Joseph Qiu (Temple University). This paper describes the Chinese stock market before and after recent regulatory changes. Empirical results show evidence of a money grab (quan qian), a particularly severe form of agency problem described in the popular press. There is evidence that firms manage earnings to qualify to make a rights issue, that insiders do not believe in the new issue because dominant shareholders tend not to subscribe in the issues. Further, the funds raised are rarely used for the purpose stated in the application for a rights issue. Generally, the results are the most pronounced when the largest shareholder is much larger than the next two.

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Theoretical Investments

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Lifetime Consumption and Investment: Retirement and Constrained Borrowing, joint with Hong Liu (Washington University). This paper looks at lifetime consumption and investment in a model with and without endogenous retirement. Unlike most papers in the area which use dodgy approximations, this paper has analytical results and the results are proven. If wages are nearly constant, endogeneity of retirement gives labor income a negative beta because retirement will be deferred in expensive states in which the market is down. The agent would like to hedge this by taking a big exposure to the market when young, but hedging may be largely infeasible if the agent faces a nonnegative wealth constraint.

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Theoretical Investments

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Preference for Foreknowledge, with L. C. G. (Chris) Rogers (Cambridge University Maths). The structure of index-linked annuities suggests that consumers have a preference for locking in minimum consumption levels in advance. This can be justified by psychological preference (perhaps rigidity in an aging person) or by discounts implied by lead time in buying illiquid assets (such as housing) or other consumptions (travel or cruises). This is a form of Kreps-Porteus preference for time resolution of uncertainty, but does not enforce a single state variable like Epstein-Zinn "recursive utility" preferences. We have closed-form solutions for strict floors and for soft floors. (theory done, awaiting my writing)

P Dybvig

Agency in Investments

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Portfolio Performance and Agency, with Heber Farnsworth (NISA) and Jennifer Carpenter (NYU). Models of agency in portfolio performance often write down a compensation contract but this does not encompass the full range of possibilities we learn from the revelation principle. Using a compensation rule that depends on portfolio choice and performance as well as constraints on what portfolios can be undertaken, we can implement the full range of contracts under the revelation principle. We show that the optimal contract gives the manager a share in the portfolio and a share in the market, similar to contracts in the market, when the signal is common knowledge. If the signal must be signalled, there is an additional reward for taking a stand, or to put it another way, a penalty for being a closet indexer.

P Dybvig

Ross Collected Works

Wash U Brown Bag, 9/12/2007

Chester Spatt and I are editing the collected works of Stephen A. Ross. Steve has more than 100 papers on his vitae, and with his input I am collecting them into volumes and sections. I am writing an essay for each section of papers. I presented a seminar (at Tsinghua) on this project and it was a lot of fun.