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Virginia Commonwealth University

PRINCIPAL-AGENT THEORY

Dynamic Insurance with Private Information and Balanced Budgets, by Cheng Wang (Carnegie Mellon University)

This paper studies a dynamic insurance problem with bilateral asymmetric information and balanced budgets. There are two infinitely-lived agents in our model, both risk averse, and each has an i.i.d. random endowment stream which is unobservable to the other. In each period, each agent must have a non-negative consumption and together they must consume the entire aggregate endowment. Dynamic incentive compatibility in the Nash sense is defined. We give sufficient and necessary conditions for the existence of a constrained efficient contract. We show that a constrained efficient contract can be characterized in a Bellman equation. We demonstrate that the long-run distribution of expected utilities of each agent is not degenerate. We also develop an algorithm for computing the efficient contract and, in a numerical example, we find that the consumption processes of the agents form stationary Markov chains. *Review of Economic Studies*, October 1995, 62(4) No. 213: 577–595. (Reprinted with permission of *Review of Economic Studies.*)

THEORY OF CONTRACTS

Contract Renegotiation: A Simple Framework and Implications for Organization Theory, by Paul Beaudry (University of British Columbia) and Michel Poitevin (Université de Montréal)

This paper provides a unifying framework for studying renegotiation of contracts in the presence of asymmetric information. We show that interim renegotiation does not constrain the set of contracts attainable with full commitment, regardless of whether renegotiation offers are made by the informed or the uninformed agent. Ex post renegotiation, however, does constrain the set of attainable contracts. These constraints depend on the identity of the agent making the renegotiation of-