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✧ 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-

fer. We then show how the theory of contract renegotiation can provide insights for organization theory. Specifically, we show how decentralization of decision making can be an optimal response to the threat of ex post renegotiation. Finally, we show that our framework can be used to analyse the trade-off between internal and external markets. *Canadian Journal of Economics*, May 1995, 28(2): 302–335. (Reprinted with permission of *Canadian Journal of Economics*.)



RISK PERCEPTION AND ECONOMIC BEHAVIOR

Testing Credit and Blame Attributions as Explanation for Choices under Ambiguity, by Kimberly A. Taylor (Florida International University)

People make decisions every day based on their estimates of the chances of various events occurring. By their very nature, these subjective estimates are less certain, and thus more ambiguous, than objective probabilities such as those associated with roulette wheels or lotteries. In two experimental studies, we investigate choices between bets on the decision maker's knowledge versus bets on a lottery with the same chance of winning. In Study 1, we partially replicate the Heath and Tversky (1991) finding that subjects have an increasing preference for betting on their own knowledge over the matched-chance lottery as probability increases. We also discover a significant minority of subjects who exhibit the opposite pattern and prefer the lottery as probability increases. In addition, we explicitly test the subjects' attributions about the credit they would feel for a win and the blame they would feel for a loss, and these attributions do provide some explanation for their choice behavior. In Study 2, we manipulate knowledge and accountability, in an attempt to heighten the attributions of credit and blame, and we replicate the findings. *Organizational Behavior and Human Decision Processes*, November 1995, 64(2): 128–137. (Reprinted with permission of *Organizational Behavior and Human Decision Processes*.)

Optimal Per Claim Deductibility in Insurance with the Possibility of Risky Investments, by Jostein Paulsen (University of Bergen, Norway)

In this paper we study the problem of optimal level of deductibility in an insurance contract when there is a deductible on each claim and the number of claims is Poisson distributed. Using new results in the theory of risk aversion and in actuarial risk theory, we prove that known results in the case when the deductible is on total claim amount carry over to this more "realistic" model. We also extend the model to allow for investment in a risky asset, analysing the interplay between buying insurance and investing risky. *Insurance: Mathematics and Economics*, October 1995, 17(2): 133–147. (Reprinted with permission of North-Holland Publishing Company.)

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