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Financial Contracting and the Business Cycle
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Financial Contracting and the Business Cycle: Syllabus

This short graduate course discusses the implications of financial contracting for the business cycle and should be of interest to students of financial economics and/or macroeconomics. The topics include the effect of financial constraints due to agency problems and collateral constraints on economic activity and asset prices, the role of the capital of financial intermediaries, as well as the impact of financial constraints on capital reallocation. The course focuses on the theoretical literature, but relevant stylized empirical facts will also be discussed.

No background beyond first year graduate economics is required. Familiarity with recursive macroeconomics and corporate finance/contract theory is useful, however; as a reference, I recommend L. Ljungqvist and T. Sargent, 2004, *Recursive Macroeconomic Theory*, 2nd edition, MIT, and J. Tirole, 2006, *The Theory of Corporate Finance*, Princeton, or P. Bolton and M. Dewatripont, 2005, *Introduction to the Theory of Contracts*, MIT, respectively.

You can contact me by email at rampini@duke.edu. A web page with additional course information is available at http://faculty.fuqua.duke.edu/~rampini/oslo.htm.

The papers marked with a "*" will be discussed in detail. To prepare for the course, please read these four papers. In addition, a practice problem is posted on the course web page; solving this problem should also help you prepare for the course.

1. Financing Constraints and Business Cycles

* Bernanke, B., and M. Gertler, 1989, Agency costs, net worth, and business fluctuations, *American Economic Review* 79, 14-31.

Scheinkman, J., and L. Weiss, 1986, Borrowing constraints and aggregate economic activity, *Econometrica* 54, 23-45.

Carlstrom, C., and T. Fuerst, 1997, Agency costs, net worth, and business fluctuations: a computable general equilibrium analysis, *American Economic Review* 87, 893-910.

Bernanke, B., M. Gertler, and S. Gilchrist, 1999, The financial accelerator in a quantitative business cycle framework. In: Taylor, J., and M. Woodford (Eds.), *Handbook of Macroeconomics*, Vol. 1C, North-Holland, Amsterdam, pp. 1341-1393.

Rampini, A., 2004, Entrepreneurial activity, risk, and the business cycle, *Journal of Monetary Economics* 51, 555-573.

2. Collateral and Asset Prices

* Kiyotaki, N., and J. Moore, 1997, Credit cycles, *Journal of Political Economy* 105, 211-248.

Shleifer, A., and R. Vishny, 1992, Liquidation values and debt capacity: a market equilibrium approach, *Journal of Finance* 47, 1343-1366.

Kehoe, T., and D. Levine, 1993, Debt-constrained asset markets, *Review of Economic Studies* 60, 865-888.

Cooley, T., R. Marimon, and V. Quadrini, 2004, Aggregate consequences of limited contract enforceability, *Journal of Political Economy* 112, 817-847.

3. Liquidity and Economic Activity

* Holmström, B., and J. Tirole, 1997, Financial intermediation, loanable funds, and the real sector, *Quarterly Journal of Economics* 112, 663-691.

  Holmström, B., and J. Tirole, 1998, Private and public supply of liquidity, *Journal of Political Economy* 106, 1-40.

4. Capital Reallocation

* Eisfeldt, A., and A. Rampini, 2007, Managerial incentives, capital reallocation, and the business cycle, *Journal of Financial Economics*, forthcoming.

  Jovanovic, B., and P. Rousseau, 2002, The Q-theory of mergers, *American Economic Review Papers and Proceedings* 91, 336-341.

  Caballero, R., and M. Hammour, 2005, The cost of recessions revisited: A reverse-liquidationist view, *Review of Economic Studies* 72, 313-341.

  Eisfeldt, A., and A. Rampini, 2006, Capital reallocation and liquidity, *Journal of Monetary Economics* 53, 369-399.