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| Abstract: | This thesis comprises three essays on the effects of asymmetric information on macroeconomic and financial market outcomes. In Chapter 1, coauthored with Zongbo Huang and Michael Sockin, I embed imperfect substitutability across skill levels into a dynamic Mirrlees model and uncover a novel intertemporal wage compression channel in optimal labor taxation that can rationalize redistributive programs such as the Earned Income Tax Credit. This dynamic channel lowers the optimal tax rate at the bottom because it allows the planner to reduce the cost of providing insurance to unskilled workers while deterring skilled workers from misreporting. The optimal labor tax is progressive in the short-run and our channel is quantitatively significant compared to other channels highlighted in the literature. In Chapter 2, I study the first-order approach in a class of continuous time dynamic mechanism design problems. This class of models has many applications in macroeconomics including insurance and optimal taxation. By working in continuous time, I take advantage of newly-developed techniques and I establish a novel sufficient condition for the optimal contract as implied by the first-order approach to be globally optimal: agents cannot overreport their shocks. This condition is simple, can be imposed ex ante, and is satisfied anyway in most settings. In Chapter 3, I develop a simple model of the banking sector to explain three facts about the subprime mortgage boom: the unprecedented expansion of the non-agency mortgage-backed security market, securitized mortgages defaulted at a higher rate than did retained mortgages, and household income growth was negatively correlated with credit expansion and house prices. Commercial banks are regulated and raise funds via deposits while shadow banks are unregulated and fund themselves by securitizing mortgages. Commercial banks retain their loans, giving them skin in the game and an incentive to screen out subprime borrowers, while shadow banks do not screen, thus lending to subprime borrowers. Unlike commercial banks, a shadow bank's funding capacity depends on economic fundamentals and they supply more credit when it is easier to securitize mortgages. The economy with shadow banks is unstable and prone to large price and welfare jumps. |
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