Discussion

Moral Hazard Misconceptions: the Case of the Greenspan Put

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AEA Meetings
January 7th 2017

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- Careful analysis of how **positive/normative arguments interplay**
- Broader message: "moral hazard" informal arguments are at times misguided

Outline

1. Description of environment
2. Discussion the results
3. Suggestions

Environment

- Three periods, two agents (A, B):
  - A maximizes
$$c_1^A + \mathbb{E}\left[u\left(c_2^A\right) - v\left(n_A^2\right) + u\left(c_3^A\right)\right]$$
  - B (borrower) maximizes
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  - Single source of uncertainty (maps to asset prices)
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- Key choices:
  - Borrowing/saving decision at $t = 1$
  - Consumption/saving decision at $t = 2$

Policy framework

- Three policy instruments
  1. **Nominal rate** (crucially real rate in date 2)
  2. Subsidy on intermediates
  3. **Macroprudential tax** on borrowing

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- Ex-ante welfare maximization with transfers
- Why are 2 and 3 (potentially) different?
  - Policy tradeoff between aggregate demand management and distributional issues (incomplete markets)

Optimal monetary policy (no macroprudential yet)

- **Rigid regime**

$$\frac{dW}{dr} = \mathbb{E}\left[\underbrace{\left(u'\left(c_2^A\right) - v'\left(Y\right)\right)}_{\text{output gap}}\underbrace{\frac{\partial Y}{\partial r}}_{\text{AD}}\right] + \mathbb{E}\left[\underbrace{\left(u'\left(c_2^A\right) - \beta u'\left(c_2^B\right)\right)}_{\text{distributional wedge}}\frac{\overbrace{Y + D - c_2^A}^{>0}}{1+r}\right]$$

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  - Third best
    - Aggregate demand + pecuniary tradeoff
    - Lack of state contingency

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- **Output gap stabilization**

$$u'\left(c_2^A\right)-v'\left(Y\right)=0$$

- Myopic interpretation

Main results: comments/suggestions

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- Interesting: flexible and output gap targeting policies with log utility implement same allocation
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- Suggestion: rigid regime normative result (overborrowing) is closely related to the work on ZLB/pegs
  - It would useful to relate more to those results

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- Outside of log utility: effects harder to characterize
  - Flexible and output gap targeting: example in which macroprudential policy is still needed
  - Rigid regime: overborrowing result survives

Final suggestions

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    - Parameter combinations are associated with higher debt?
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4. What if the **change in prices is not coming from fundamentals**
   - Time varying price of risk

Conclusion

- Contributes to understand the interaction between monetary and macroprudential policy
- The paper is very clear, in a context in which it is hard to get clean results
- Very important question
- Scope for further work on the topic