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DEBTORS' REPAYMENT BEHAVIOR AND LOW-RISK INSURANCE STATUS

The authors present a theory of unsecured consumer debt that does not rely on utility costs of default or on enforcement mechanisms that arise in repeated-interaction settings. The theory is based on private information about a person's type and on a person's incentive to signal his type to entities other than creditors. Specifically, debtors signal their low-risk status to insurers by avoiding default in credit markets. The signal is credible because in equilibrium people who repay are more likely to be the low-risk type and so receive better insurance terms. The authors explore two different mechanisms through which repayment behavior in the credit market can be positively correlated with low-risk status in the insurance market. Their theory is motivated in part by some facts regarding the role of credit scores in consumer credit and auto insurance markets.

Working Paper 07-14, "A Finite-Life Private-Information Theory of Unsecured Consumer Debt," Satyajit Chatterjee, Federal Reserve Bank of Philadelphia; Dean Corbae, University of Texas at Austin; and José-Víctor Ríos-Rull, University of Pennsylvania

FIRM DYNAMICS AND THE MARKET FOR IDEAS

The authors propose a theory of firm dynamics in which workers have ideas for new projects that can be sold in a market to existing firms or implemented in new firms: spin-offs. Workers have private information about the quality of their ideas. Because of an adverse selection problem, workers can sell their ideas to existing firms only at a price that is not contingent on their information. The authors show that the option to spin off in the future is valuable, so only workers with very good ideas decide to spin off and set up a new firm. Since entrepreneurs of existing firms pay a price for the ideas sold in the market that implies zero expected profits for them, firms' project selection is independent of their size, which, under some assumptions, leads to scale-independent growth. The entry and growth process of firms in this economy leads to an invariant distribution that resembles the one in the U.S. economy.

Working Paper 07-15, "Spin-Offs and the Market for Ideas," Satyajit Chatterjee, Federal Reserve Bank of Philadelphia, and Esteban Rossi-Hansberg, Princeton University