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# WIRTSCHAFTSTHEORETISCHES FORSCHUNGSSEMINAR

## RESEARCH SEMINAR IN ECONOMIC THEORY

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**January 29, 2009**

Hörsaal II

Institut für Höhere Studien  
Stumpergasse 56, 1060 Wien

**4:00pm**

**Paul Heidhues,**

*University of Bonn and CEPR:*

***“Exploiting Naivete about Self-Control in the Credit Market”***

Abstract printed on the next page

**5:30pm**

**R. Anton Braun,**

*University of Tokyo:*

***“The quantitative effects of monetary aggregate targeting  
in a zero interest rate environment: results from Japan”***

Abstract printed on the next page

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DOWNLOAD SITE FOR PAPERS (IF AVAILABLE) AND SEMINAR SCHEDULE

<http://www.univie.ac.at/vwl/EconomicTheory.html>

NOTE: Participation of advanced students in this seminar is highly recommended.

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## **Paul Heidhues,**

*University of Bonn and CEPR:*

### ***“Exploiting Naivete about Self-Control in the Credit Market”***

We analyze behavior and welfare in a competitive credit market where borrowers with different tastes for immediate gratification and prior beliefs about that taste sign long-term contracts specifying a loan amount and a menu of repayment schedules. Consistent with many credit-card and mortgage contracts, a competitive-equilibrium contract features an advantageous schedule involving overly front-loaded repayment, but imposes a discontinuous fee for any delay relative to this schedule. Fully sophisticated borrowers repay at the fast rate, but all other borrowers, including those with an arbitrarily small amount of naivete, put off the bulk of the repayment to later. Furthermore, because non-sophisticated borrowers believe they will repay quickly, they underestimate the cost of credit, and hence borrow too much given their preferences at the time of signing. Due to these mistakes, non-sophisticated consumers have discontinuously lower welfare than sophisticated ones. We identify natural conditions under which the above results obtain even if firms observe neither tastes nor beliefs—because all non-sophisticated consumers endogenously choose contracts for which they discretely mispredict their future behavior. Requiring credit contracts to have a linear structure prevents non-sophisticated but not-too-naive borrowers from severely mispredicting their behavior, so this intervention can raise welfare.

with Botond Köszegi (University of California, Berkeley).

## **R. Anton Braun,**

*University of Tokyo:*

### ***“The quantitative effects of monetary aggregate targeting in a zero interest rate environment: results from Japan”***

What are the effects of monetary aggregate targeting in a zero nominal interest rate environment? This paper develops a computable overlapping generations model to answer this question. In our model there are two sources of real balance effects: finite lifespans and borrowing constraints. Steady-state results reveal an asymmetry in the welfare costs of alternative monetary policies. A monetary aggregate targeting policy that is too tight has large and negative effects on welfare. A loose monetary aggregate targeting policy has much smaller effects on welfare. A dynamic analysis using data from Japan finds that the “quantitative easing” policy reduced deflationary pressure. Although the effects of this policy on GNP growth are small, there are important distributional effects. The biggest beneficiaries of this policy are the young who experience an easing in borrowing constraints and the old who benefit from lower taxes and higher interest rates. Individuals in other age groups experience consumption losses.

with Takemasa Oda (Bank of Japan).

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