

# DISSERTATION DEFENSE

Richard Lowery

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3:30 pm

388 Posner Hall

**“Cooperation in Infinite Games: Applications to Finance and Public Economics”**

## **Essay 1: Financial Intermediation, Trust, and Asset Values**

In thin financial markets where intermediation is necessary to facilitate exchange, the intermediary may have an informational advantage in addition to his cost advantage for acquiring the security. If all information is eventually revealed, the intermediary may have an incentive to truthfully reveal the value of the security to a customer as soon as he learns it rather than attempting to profit from the asymmetric information. Whether this incentive is sufficiently strong depends on the patience of the intermediary and the probability that he will have future interactions with the same client. This probability depends on the value of the security because declining values lead to increased risk that the intermediary will fail. I study a model of repeated interaction between clients and intermediaries that takes into account the correlation between value and continuation probabilities. The model captures the unresponsiveness of thinly traded securities to bad news and explains the breakdown in liquidity following declines in asset values. This fact can help explain why relatively illiquid securities, such as those based on subprime mortgages, can experience apparent bubbles and crashes.

## **Essay 2: Imperfect Monitoring and Fixed Spreads in the Market for IPOs**

Characteristics of the investment banking industry, particularly the extreme concentration of spreads at exactly 7%, seem consistent with some form of collusion through which underwriters can extract surplus from the IPO. I present a model of investment banking that, under the assumption of optimal collusion, generates a distribution of spreads qualitatively similar to that observed. The model is extended to show that underpricing and spread rigidity may arise together, each one reinforcing incentives to engage in the other.

## **Essay 3: Social Capital as Economic Overlap**

This paper presents a model of endogenous social capital where location decisions can generate the necessary means to sustain cooperative behavior in the absence of legal institutions or social conventions. By choosing to locate close to each other, agents create public goods that facilitate cooperative behavior on other endeavors. The model can serve to explain both initial agglomeration decisions and cooperation in extra-legal environments, even in the absence of frequent repetition.