

Repeated Interactions Under Costly Enforcement.*

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The paper URL

<http://www.citi.umich.edu/u/galka/w/su.pdf>

Abstract

We study repeated irreversible investment. We assume that *ex ante* ownership rights are incomplete and *ex post* property allocation is endogenous. In a stage game, principal can renege on *ex ante* contract with agents (investors). To capture that ownership rights depend on prior arrangements, we introduce a dynamic game, in which player *ex ante* ownership shares are equal to their *ex post* shares in the stage game of the previous period. With the commitment constrained principal, equilibrium of the dynamic game features cyclical changes in investment. These cycles indicate that contractual incompleteness alone causes output fluctuations. Thus, when costly contracts result in constrained commitment, persistent cycles in output occur, resembling business cycles.

Keywords: Dynamic Games, Costly Contracts, Endogenous Ownership
JEL Classification Codes: C73, E30

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