RISK SHARING IN DYNAMIC RELATIONAL CONTRACTS

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This paper considers a long-term relationship between two risk averse agents who undertake joint investments. Agents have an opportunity to expropriate some of the joint benefit for their own use. The question asked is how to structure the investments and division of the surplus over time so as share risk and maximise surplus. Convergence to an invariant distribution is shown. For some parameterisations the invariant distribution is degenerate and the long-run outcome is a stationary state. In other case the invariant distribution is unique and in further cases the long-run invariant distribution depends on initial conditions. We show convergence to the dynamics of the pure risk-sharing case when agents cannot vary investments.

KEYWORDS: Risk sharing · relational contracts · limited commitment

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