

# Advanced Microeconomics

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## Problem 1

Proof: Follows from FOC, consistency and cyclical argument analogous to Aguiar and Kashev (2020)(AK2020).

## Problem 2

Summing and rearranging, we get

$$d_A^t(v_{t,A} - v_{s,A}) - d_B^t(v_{t,B} - v_{s,B}) \geq \rho_t'(c_t^* - c_s^*) \forall t, s \in T$$

which is the determinisitc test analogous to the stochastic version Appendix E in AK2020.

Testing this deterministic model in a grid for  $d_i \in [0.1, 1], i = \{A, B\}$  in increments of 0.05, I get a rejection rate of 95.86%. Which is high compared to the stochastic version in AK2020. Code can be found in my github website.

## Problem 3

I think a way to test this simpler model, we could use the Method of Simulated Moments (MSM). We can define that the probability of individual  $i$  to be rational under this model, and the two given moments is the following

$$\begin{aligned} P(\text{individual } i \text{ is rational}) &= P(\mathbb{1}\{0 \geq (\rho_t - \rho_s)'(c_t - w_t - c_s + w_s)\}, \mathbb{E}[\rho_t c_t] = \rho_t^* c_t^*) \\ &= \frac{1}{N} \sum \mathbb{1}(0 \geq (\rho_t - \rho_s)'(c_t - w_t - c_s + w_s), \mathbb{E}[\rho_t c_t] = \rho_t^* c_t^*) \end{aligned}$$

So, we could simulate  $\{w_t\}_{s=1}^S$  for each individual and estimate the model above.

For S=1000, I tested the model above and could get a 95.3% rejection rate in contrast to the 100% of the deterministic case. The result might seem low, however if we consider the restrictions on rationality this model imposes on individuals this might not seem as unlikely.(code).