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# Intertemporal equilibrium with heterogeneous agents, endogenous dividends and collateral constraints<sup>‡</sup>

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## Abstract

We build a dynamic general equilibrium model with heterogeneous producers and financial frictions (collateral constraints and incompleteness). First, we provide a characterization to check whether a sequence is an equilibrium or not. Second, we study the effects of financial imperfections on output and land prices. Third, we develop a theory of valuation of land by introducing the notion of endogenous land dividends (or yields) and different concepts of land-price bubbles. Some examples of bubbles are provided in economies with and without short-sales.

**Keywords:** Infinite-horizon, general equilibrium, collateral constraint, incomplete markets, asset valuation, rational bubbles.

**JEL Classifications:** C62, D53, D9, E44, G10.

## 1 Introduction

The interplay between asset prices and economic activities is an important topic, especially after the Great Recession. A vast literature has flourished on this transmission mechanism focusing on the notion of asset-price bubble. Many articles have addressed this issue in overlapping generations (OLG) models (Tirole, 1985; Farhi and Tirole, 2012; Martin and Ventura, 2012) while others have adopted an infinite-lived agent’s approach (Tirole, 1982; Santos and Woodford, 1997; Kocherlakota, 2009; Hirano and Yanagawa, 2017). However, most of this literature ignores the productive role of assets. Our paper aims to develop a theory of asset valuation in the case the asset is not only a collateral but also an input. We contribute to explain the asset pricing in terms of production activity. Although many

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papers have raised the question of asset valuation, most of them have focused on assets with exogenous positive dividends (Lucas, 1978; Santos and Woodford, 1997) or zero dividend (Bewley, 1980; Tirole, 1985; Pascoa et al., 2011). Unlike this literature, in our paper, every agent can use the asset to produce the consumption good according to her own technology. More precisely, we consider an infinite-horizon general equilibrium model with three assets: a consumption good, land (to produce the consumption good), and a short-live financial asset with zero supply. There is a finite number of agents who differ in terms of endowments, technology, preferences and borrowing limits. In each period, agents may produce, exchange and consume. In the spirit of Geanakoplos and Zame (2002) and Kiyotaki and Moore (1997), agents can borrow but must hold land as collateral. The repayment does not exceed a given fraction of land income (the sum of the value of land and its fruit) because there is lack of commitment.

We start our exposition by proving that a list of prices and allocations constitutes an equilibrium if and only if it satisfies first-order, transversality, and market clearing conditions as well as budget and borrowing constraints. The challenge and key point is the necessity of transversality conditions. To prove this, we develop the methods in Kamihigashi (2002) and Araujo et al. (2011), Pascoa et al. (2011). Our necessary and sufficient condition allows us to check whether a sequence is an equilibrium or not. It should be noticed that our proof can apply to a large class of general equilibrium models used in macroeconomics. It contributes to the novelty of the paper.

The general equilibrium perspective is suitable to represent the interference between financial markets and economic activities. Some of equilibrium properties deserve mention.

(1) In deterministic economies, if any agent produces (this happens under Inada's condition), then agents' marginal productivities turn out to be the same. Cases where some agents give up the production are quite specific: they experience a very low productivity while the others have high productivity and a full access to credit markets. However, it should be noticed that when financial markets are incomplete or agents are prevented from borrowing, the most productive agent may not buy land to produce. We provide examples illustrating this idea.

(2) The steady state analysis is carried out in a simple case.<sup>1</sup> In the long run, the most patient agent may not hold the entire stock of land. This result challenges the well-known Ramsey's conjecture (the most patient individual owns all the capital in the long run) and looks more realistic. The very reason is that, in our model, any agent is a producer differently from what happens in the growth literature where consumers rent capital to a representative firm (see Becker and Mitra (2012) among others).

The last part of the paper develops a theory of land valuation. We focus on rational land-price bubbles and their economic consequences.<sup>2</sup> The standard literature (Lucas, 1978; Santos and Woodford, 1997) considers long-lived assets paying exogenous dividends. In our model, any agent may produce with a landowner-specific technology which may be non-linear; this prevents the standard approach from applying. Now, one unit of land yields an endogenous amount of consumption good in the next period, the so-called *dividend* or *added-value of land*. In deterministic economies,<sup>3</sup>  $(\gamma_t, d_t)$  is called a process of state-prices and land dividends if the the following intertemporal asset-pricing equation holds:

$$q_t = \gamma_{t+1} (q_{t+1} + d_{t+1}) \tag{1}$$

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<sup>1</sup>The steady state may not exist when endowments are not stationary.

<sup>2</sup>A survey on bubbles with asymmetric information, overlapping generations, heterogeneous beliefs can be found in Brunnermeier and Oehmke (2012).

<sup>3</sup>For the sake of simplicity, we mention here only the deterministic case. The stochastic one is presented in Section 6.

jointly with the condition that the dividend  $d_{t+1}$  is higher than the lowest marginal productivity of agents (the latter condition is required because every agent is allowed to produce). Here,  $q_t$  is the land price in terms of consumption good. Equation (1) is a no-arbitrage condition: what we pay today to buy 1 unit of land is equal to what we will receive by reselling 1 unit of land plus land dividends (in terms of consumption good). Of course, when agents share the same linear technology, we recover the Lucas' tree with exogenous dividends. Santos and Woodford (1997) and Montrucchio (2004) also use no-arbitrage conditions to define state-price process. They then use them to evaluate assets having exogenous dividends in economies with incomplete financial markets.

In our economy, land plays three different roles: once we buy land, we can (1) resell it, (2) use it to produce or (3) to borrow (collateral role). The land dividend represents the two last roles. According to the literature (Tirole, 1982; Santos and Woodford, 1997), the fundamental value of land is defined at equilibrium as the sum of the discounted values of such endogenous dividends and the *bubble* is the (positive) difference between the price of land and its fundamental value. Our approach is suitable not only for deterministic but also for stochastic economies.

Our general result indicates that when agents are uniformly impatient, for any process of state-price and dividends such that the discounted value of aggregate consumption good vanishes at the infinity, the price of land equals its fundamental value. This can be viewed as an extension of Theorem 3.3 in Santos and Woodford (1997)<sup>4</sup> to the case of productive assets. We also prove that, under uniform impatience in bounded economies, bubbles are ruled out for any process of state-price and dividends.

The assumption of uniform impatience can be removed in the case of deterministic economies. In such a case, we find out some interesting features. Let us mention two of them. First, a land-price bubble arises only if the borrowing constraints of some agent are binding infinitely many times.<sup>5</sup> Indeed, when the borrowing constraints are not binding, the marginal rates of substitution of all agents are the same and, hence, the no-bubble condition becomes equivalent to a no-Ponzi scheme. Since the transversality conditions are satisfied, the no-bubble condition is verified as well. Second, there is always one agent whose expected value of land equals the land price.

We also provide some new examples of bubbles in economies with and without short-sales. In the first one, agents are prevented from borrowing, their endowments fluctuate over time and/or technologies are non-stationary. Some agents face a drop in endowments at time  $t$ , but are unable to borrow and transfer wealth from period  $t + 1$  to period  $t$ . Thus, they may buy land at date  $t - 1$  at a higher price, independent on their technologies, in order to transfer their wealth from date  $t - 1$  to date  $t$ . When the agents' TFP goes to zero, the fundamental value of land tends to zero as well, below the above level of price. By consequence, a land bubble arises. In the second example, short-sales are allowed but borrowing constraints still work. As in the first example, at any date, at least one agent is forced to save, hence she may accept to buy land at a higher price or to buy a financial asset with low interest rates. Therefore, bubbles may occur.

Our concept of land bubble contributes to the literature on bubbles of assets delivering endogenous dividends. Among others, three approaches deserve mention.

Araujo et al. (2011), Pascoa et al. (2011) introduce and study concepts of bubbles of

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<sup>4</sup>Theorem 3.3 in Santos and Woodford (1997) shows that, under uniform impatience, assets in positive net supply and exogenous dividend have no bubble for state-prices that yield finite present values of aggregate endowments

<sup>5</sup>This is only a necessary condition for the existence of bubble. This issue will be addressed in Sections 5.1.1 and 5.2.

durable goods, collateralized assets and fiat money. They provide asset-pricing conditions based on the existence of so-called *deflators* and *non-pecuniary returns*; then, they use them to define bubbles. In the current paper, we focus on land and non-linear production functions.

Miao and Wang (2012, 2015) consider bubbles on the firm's value with endogenous dividends. They split this value in two parts:  $V(K) = QK + B$ , where  $K$  is the initial stock of the firm,  $Q$  is the marginal Tobin's  $Q$  ( $Q$  is endogenous) and  $B$  is the bubble. They interpret  $Q$  as the fundamental value of firm. This approach, which is different from ours, cannot be directly applied for valuation of land in our model because land is used by many agents while a stock in Miao and Wang (2012, 2015) is issued by only one firm and stock dividends are taken as given by other agents.

Becker et al. (2015), Bosi et al. (2017a) introduce the concept of physical capital bubble in one- and two-sector models. They define the fundamental value of physical capital as the sum of discounted values of capital returns (net of depreciation). As above, a physical capital bubble exists if the equilibrium price of physical capital exceeds its fundamental value. In our model, land, as input, looks like capital. The difference is that Becker et al. (2015), Bosi et al. (2017a) consider a representative firm while, in our work, each agent can be viewed as an entrepreneur.

The rest of the paper is organized as follows. Section 2 presents the framework and provides basic equilibrium properties. Sections 3 and 4 study the role of financial market imperfections and land bubbles. Section 5 presents examples of bubbles in deterministic economies with and without short-sales. Section 6 extends our analysis to the stochastic case. Section 7 concludes. Technical proofs are gathered in the appendices.

## 2 Framework

We firstly consider an infinite-horizon general equilibrium model without uncertainty. A model with uncertainty will be presented in Section 6. The time is discrete and runs from date 0 to infinity. There is a finite number of agents and  $I = \{1, 2, \dots, m\}$  denotes the set of agents.

**Consumption good.** There is a single consumption good which is set to be the numéraire. At date  $t$ , agent  $i$  is endowed with  $e_{i,t}$  units of consumption good, and chooses to consume  $c_{i,t}$  units of this good.

**Land.** We denote by  $L$  and  $q_t$  the exogenous total supply of land and its price at date  $t$ . At this date, agent  $i$  buys  $l_{i,t}$  units of land which is used to produce  $F_i(l_{i,t})$  units of consumption good and can be sold at a price  $q_{t+1}$  at date  $t + 1$ , where  $F_i$  is the production function of agent  $i$ .

**The financial market** opens at the initial date. If agent  $i$  buys  $a_{i,t}$  units of financial asset at date  $t$  with price  $r_t$ , she will receive  $a_{i,t}$  units of consumption good at date  $t + 1$ . Agents can also borrow in the credit market. However, if they do that, they are required to hold land as collateral. The sense and the role of this constraint will be explained below.

Each household  $i$  takes the sequence of prices  $(q, r) := (q_t, r_t)_{t=0}^{\infty}$  as given and chooses sequences of consumption, land, and asset volume  $(c_i, l_i, a_i) := (c_{i,t}, l_{i,t}, a_{i,t})_{t=0}^{+\infty}$  in order to maximize her intertemporal utility

$$P_i(q, r) : \max_{(c_i, l_i, a_i)} \sum_{t=0}^{+\infty} \beta_i^t u_i(c_{i,t})$$

subject to, for all  $t \geq 0$ ,

$$l_{i,t} \geq 0 \tag{2}$$

$$c_{i,t} + q_t l_{i,t} + r_t a_{i,t} \leq e_{i,t} + q_t l_{i,t-1} + F_i(l_{i,t-1}) + a_{i,t-1} \tag{3}$$

$$a_{i,t} \geq -f_i [q_{t+1} l_{i,t} + F_i(l_{i,t})] \tag{4}$$

where  $l_{i,-1} > 0$  is given and  $a_{i,-1} = 0$  (no debt before the opening of financial markets).

Constraint (4) means that agent  $i$  can borrow an amount whose repayment does not exceed an exogenous share of land income. The parameter  $f_i$  is set by law and below 1. Parameter  $f_i$  can be viewed as the borrowing limit of agent  $i$ .

Constraint (4) can also be interpreted as a collateral constraint: agents can borrow but they must own land as collateral. In case of default, lenders can seize the fraction  $f_i$  of agent  $i$ 's land income. Here, we assume  $f_i \leq 1$  because there is lack of commitment (see [Quadrini \(2011\)](#) for a review of this issue). By the way, our model is related to the literature on general equilibrium with collateral constraints ([Geanakoplos and Zame, 2002](#); [Kiyotaki and Moore, 1997](#); [Kubler and Schmedders, 2003](#)). However, it is different from [Kiyotaki and Moore \(1997\)](#) where the repayment does not exceed the revenue from reselling land. This constraint corresponds to  $a_{i,t} \geq -q_{t+1} l_{i,t}$  in our notations. Moreover, [Kiyotaki and Moore \(1997\)](#) look at the equilibrium properties around the steady state with  $r_t$  is constant while we will provide global analysis of intertemporal equilibria.

Our model is related to [Liu et al. \(2013\)](#) where land-price dynamics are investigated. Our framework is also related to [Farhi and Tirole \(2012\)](#). However, we consider dynamic firms in an infinite-horizon GE model while they focus on firms living for 3 periods in an OLG model.

The economy, denoted by  $\mathcal{E}$ , is characterized by a list of fundamentals

$$\mathcal{E} := (u_i, \beta_i, e_i, f_i, l_{i,-1}, F_i).$$

**Definition 1.** Given the economy  $\mathcal{E}$ , a list  $\left( \bar{q}_t, \bar{r}_t, (\bar{c}_{i,t}, \bar{l}_{i,t}, \bar{a}_{i,t})_{i=1}^m \right)_{t=0}^{+\infty}$  is an intertemporal equilibrium if the following conditions are satisfied:

(i)  $\bar{q}_t, \bar{r}_t \in (0, \infty) \forall t \geq 0$ .

(ii) Market clearing: for all  $t \geq 0$ ,

$$\text{good: } \sum_{i=1}^m \bar{c}_{i,t} = \sum_{i=1}^m (e_{i,t} + F_i(\bar{l}_{i,t-1})) \tag{5}$$

$$\text{land: } \sum_{i=1}^m \bar{l}_{i,t} = L \tag{6}$$

$$\text{financial asset: } \sum_{i=1}^m \bar{a}_{i,t} = 0. \tag{7}$$

(iii) Agents' optimality: for all  $i$ ,  $(\bar{c}_{i,t}, \bar{l}_{i,t}, \bar{a}_{i,t})_{t=0}^{\infty}$  is a solution of the problem  $P_i(\bar{q}, \bar{r})$ .

Notice that the financial asset in our framework is a short-lived asset with zero supply, which is different from the long-lived asset bringing exogenous positive dividends in [Lucas \(1978\)](#), [Kocherlakota \(1992\)](#), [Le Van and Pham \(2016\)](#). When production functions are not stationary and given by  $F_{i,t}(x) = d_t x$ , land in our model corresponds to the Lucas' tree with

exogenous dividends; in particular, when  $F_i = 0 \forall i$ , land is similar to fiat money as in [Bewley \(1980\)](#) or pure bubble asset as in [Tirole \(1985\)](#).

In what follows, if we do not explicitly mention, we will work under the following assumptions.

**Assumption 1** (production functions). *For all  $i$ , the function  $F_i$  is concave, continuously differentiable,  $F_i' > 0$  and  $F_i(0) = 0$ .*

Notice that we consider both cases  $F_i'(0) = \infty$  and  $F_i'(0) < \infty$  (linear production functions satisfy this condition).

**Assumption 2** (endowments).  $l_{i,-1} > 0, a_{i,-1} = 0 \forall i$ , and  $e_{i,t} > 0 \forall i, \forall t$ .

**Assumption 3** (borrowing limits).  $f_i \in (0, 1] \forall i$ .

**Assumption 4** (utility functions). *For all  $i$ , the function  $u_i$  is continuously differentiable, concave,  $u_i(0) = 0$ ,  $u_i' > 0$ ,  $u_i'(0) = \infty$ .<sup>6</sup>*

**Assumption 5** (finite utility). *For all  $i$ ,*

$$\sum_{t=0}^{\infty} \beta_i^t u_i(W_t) < \infty, \text{ where } W_t := \sum_{i=1}^m (e_{i,t} + F_i(L)). \quad (8)$$

Under assumptions 1, 2, 3, 4, 5, there exists an intertemporal equilibrium. A proof for this result can be found in our working paper version ([Bosi et al., 2017b](#)). Notice that in this proof, we allow for non-stationary production functions. However, in this paper (except Section 5 and Section 6), we assume that the technology is stationary for the sake of notational simplicity.

## 2.1 Borrowing constraints and transversality conditions

We provide the following fundamental result: a tractable necessary and sufficient condition to check whether a sequence is an intertemporal equilibrium or not.

**Proposition 1.**

1. Let  $(q, r, (c_i, l_i, a_i)_{i=1}^m)$  be an equilibrium. There exists a positive sequence of multipliers  $(\lambda_{i,t}, \eta_{i,t}, \mu_{i,t+1})$  such that

$$\text{FOCs: } \beta_i^t u_i'(c_{i,t}) = \lambda_{i,t} \quad (9)$$

$$r_t \lambda_{i,t} = (\lambda_{i,t+1} + \mu_{i,t+1}) \quad (10)$$

$$\lambda_{i,t} q_t = (\lambda_{i,t+1} + f_i \mu_{i,t+1})(q_{t+1} + F_i'(l_{i,t})) + \eta_{i,t} \quad (11)$$

$$\eta_{i,t} l_{i,t} = 0 \quad (12)$$

$$\mu_{i,t+1} (a_{i,t} + f_i [q_{t+1} l_{i,t} + F_i(l_{i,t})]) = 0 \quad (13)$$

$$\text{Transversality condition: } \lim_{t \rightarrow \infty} \lambda_{i,t} (q_t l_{i,t} + r_t a_{i,t}) = 0 \quad (14)$$

Moreover, we have, for any  $i$ ,

$$\begin{aligned} \infty > \sum_{t=0}^{\infty} \lambda_{i,t} c_{i,t} &= \lambda_{i,0} (F_i(l_{i,-1}) + q_0 l_{i,-1}) + \sum_{t=0}^{\infty} \lambda_{i,t} e_{i,t} \\ &\quad + \sum_{t=1}^{\infty} \lambda_{i,t} \left( 1 + f_i \frac{\mu_{i,t}}{\lambda_{i,t}} \right) (F_i(l_{i,t-1}) - l_{i,t-1} F_i'(l_{i,t-1})) \end{aligned} \quad (15)$$

<sup>6</sup>In the proof of the existence of equilibrium, we do not require  $u_i'(0) = \infty$ . This condition is to ensure that  $c_{i,t} > 0$  for any  $t$ , which is used in the rest of the paper.

2. If the sequences  $(q, r, (c_i, l_i, a_i)_i)$  and  $(\lambda_i, \eta_i, \mu_i)$  satisfy

- (a)  $c_{i,t}, l_{i,t}, \lambda_{i,t}, \eta_{i,t}, \mu_{i,t+1} \geq 0; q_t, r_t > 0$  for any  $t$ ;
- (b) condition (3) is binding and conditions (2), (4), (5), (6), (7) hold for any  $t$ ;
- (c) conditions (9), (10), (11), (12), (13), (14) hold for any  $t$ ;
- (d)  $\sum_{t=0}^{\infty} \beta_i^t u_i(c_{i,t}) < \infty$ ;

then  $(q, r, (c_i, l_i, a_i)_i)$  is an intertemporal equilibrium.

*Proof.* See Appendix A. □

The challenge and key point of Proposition 1 is the necessity of transversality conditions (14). To prove this, we develop the method in Kamihigashi (2002). Recall that Kamihigashi (2002) only considers positive allocations while asset volume  $a_{i,t}$  may be negative in our model. The detailed proof of this result is presented in Appendix A.

According to (10), we have  $r_t \lambda_{i,t} \geq \lambda_{i,t+1} \forall i$ . Since  $f_i > 0 \forall i$ , it is easy to see that there exists an agent  $i$  whose borrowing constraint (4) is not binding. Thus  $\mu_{i,t+1} = 0$  which implies that  $r_t \lambda_{i,t} = \lambda_{i,t+1}$ . As a result, we obtain the following result:

**Lemma 1.** *We have*

$$r_t = \max_{i \in \{1, \dots, m\}} \frac{\beta_i u'_i(c_{i,t+1})}{u'_i(c_{i,t})} \quad (16)$$

We define the discount factor  $\gamma_{t+1}$  ( $\gamma_{i,t+1}$ ) of the economy (agent  $i$ ) from date  $t$  to date  $t+1$ , and the discount factor  $Q_t$  ( $Q_{i,t}$ ) of the economy (agent  $i$ ) from the initial date to date  $t$  as follows

$$\begin{aligned} \gamma_{t+1} &:= \max_{i \in \{1, \dots, m\}} \frac{\beta_i u'_i(c_{i,t+1})}{u'_i(c_{i,t})}, \quad Q_0 := 1, \quad Q_t := \gamma_1 \dots \gamma_t = r_0 \dots r_{t-1} \\ \gamma_{i,t+1} &:= \frac{\beta_i u'_i(c_{i,t+1})}{u'_i(c_{i,t})}, \quad Q_{i,0} := 1, \quad Q_{i,t} := \gamma_{i,1} \dots \gamma_{i,t} = \frac{\beta_i^t u'_i(c_{i,t})}{u'_i(c_{i,0})} \end{aligned}$$

Note that  $\gamma_{i,t} \leq \gamma_t$  for any  $i$  and  $t$ . According to Alvarez and Jermann (2000),  $Q_t$  can be interpreted as the price of one unit of aggregate good in date  $t$  in units of consumption good in date 0. We rewrite constraint (4) as

$$Q_{t+1} a_{i,t} \geq -f_i Q_{t+1} [q_{t+1} l_{i,t} + F_i(l_{i,t})]$$

According to definition of  $(Q_t)$  and Lemma 1, we see that  $Q_{t+1} = Q_t r_t$ . Therefore, borrowing constraint (4) is equivalent to

$$Q_t r_t a_{i,t} \geq -f_i Q_{t+1} [q_{t+1} l_{i,t} + F_i(l_{i,t})]$$

**Corollary 1** (fluctuation of borrowing constraints). *At equilibrium, we have:*

1. For each  $i$ , there are only two cases:

- (a)  $\lim_{t \rightarrow \infty} \left( Q_t r_t a_{i,t} + f_i Q_{t+1} (q_{t+1} l_{i,t} + F_i(l_{i,t})) \right)$  does not exist;
- (b)  $\lim_{t \rightarrow \infty} \left( Q_t r_t a_{i,t} + f_i Q_{t+1} (q_{t+1} l_{i,t} + F_i(l_{i,t})) \right) = 0$ .



2. (transversality condition, version 2) We have, for all  $i$ ,

$$\liminf_{t \rightarrow \infty} \left( Q_t r_t a_{i,t} + f_i Q_{t+1} (q_{t+1} l_{i,t} + F_i(l_{i,t})) \right) = 0 \quad (17)$$

*Proof.* See Appendix A. □

We observe that there are two kinds of transversality conditions. The first one is (14) which is determined by the individual discount factor  $\beta_i^t u_i'(c_{i,t})/u_i'(c_{i,0})$ . It characterizes the optimality of agent  $i$ 's allocations. The second one is (17) based on the economy discount factor  $Q_t$  and it clarifies the role of borrowing constraints.

**Remark 1.** *All the results in this section apply also to non-stationary production functions.*

### 3 The role of the financial market

For each  $t \geq 1$ , we introduce two productive bounds:

$$\underline{d}_t := \min_{i \in \{1, \dots, m\}} F_i'(l_{i,t-1}), \quad \bar{d}_t := \max_{i \in \{1, \dots, m\}} F_i'(l_{i,t-1}).$$

We have the following result showing the relationship among land prices, marginal productivities, interest rates and borrowing limits.

**Lemma 2.** *The relative price of land is governed by the following inequalities:*

$$\gamma_{t+1}(q_{t+1} + \underline{d}_{t+1}) \leq q_t \leq \gamma_{t+1}(q_{t+1} + \bar{d}_{t+1}) \quad (18)$$

$$f_i \gamma_{t+1}(q_{t+1} + F_i'(l_{i,t})) \leq q_t \quad (19)$$

for any  $i$  and  $t$ .

*Proof.* See Appendix B. □

According to (18), we introduce the concept of land dividends (or added-value of land, or land yields).

**Definition 2 (dividends of land).** *The dividends of land  $(d_t)_t$  is defined by the following no-arbitrage condition*

$$q_t = \gamma_{t+1}(q_{t+1} + d_{t+1}) \quad (20)$$

**Interpretation.** Once we buy land, we will be able to resell it and expect to receive an amount. This amount is exactly the dividend of land defined by (20). Equation (20) says that what we pay to buy 1 unit of land at date  $t$  is equal to what we will receive by reselling 1 unit of land plus the dividend of land (in terms of consumption good). When technologies are linear and identical ( $F_i(X) = dX$  for any  $i$ ), we have  $d_t = d$  for any  $t$ , and hence we recover the Lucas' tree. In our general setup, (18) implies that land dividend  $d_t$  is greater than the lowest marginal productivity  $\underline{d}_t$  but less than the highest one  $\bar{d}_t$ .

In our model, land has a threefold structure: after buying land at date  $t$ , agents (1) resell it at date  $t + 1$ , (2) use it as collateral in order to borrow from financial markets and (3) receive an amount of consumption good from their production process. Definition 2 states that dividends are endogenous and capture the roles (2) and (3) of land. In fact, because land is resold and gives dividends at each date, (20) can be interpreted as an asset-pricing or a no-arbitrage condition.

We point out some interesting properties of land dividends.

**Lemma 3** (fair financial system).  $d_{t+1} = \bar{d}_{t+1}$  if  $f_i = 1 \forall i$  or (4) is not binding for any  $i$ .

*Proof.* See Appendix B. □

We can interpret  $f_i = 1$  as a full access to credit market for agent  $i$ . Lemma 3 points out that the land dividend equals the highest marginal productivity if either anyone may fully enter the credit market or borrowing constraints of any agent are not binding.

This following result shows that dividends equal the lowest marginal productivities if every agent buys land.

**Proposition 2.** Focus on date  $t$  and assume  $l_{i,t-1} > 0 \forall i$ . In this case,  $d_t = \underline{d}_t$ .

*Proof.* See Appendix B. □

We highlight some consequences of Lemma 3 and Proposition 2.

**Corollary 2.** 1. If  $F'_i(0) = +\infty \forall i$ , then  $d_t = \underline{d}_t \forall t$ .

2. (equal marginal productivities.) If  $\mu_{i,t} = f_i \mu_{i,t}$ <sup>7</sup> and  $l_{i,t-1} > 0$ , then  $F'_i(l_{i,t-1}) = d_t \forall i$ .

3. If  $f_i = 1$  and  $F'_i(0) = \infty$  for any  $i$ , then  $d_t = F'_i(l_{i,t-1}) \forall i, \forall t$ .

### 3.1 Who buys land? Who needs credits?

In this section, we point out conditions under which agents become producers and/or borrowers. First, land demand depends on agents' productivity.

**Proposition 3.** If  $l_{i,t} > 0$ , then  $F'_i(l_{i,t}) \geq d_{t+1}$ .

If  $F'_i(l_{i,t}) > d_{t+1}$ , then borrowing constraint (4) of agent  $i$  is binding.

*Proof.* See Appendix B. □

The first statement means that if an agent buys land, its marginal productivity must be greater than land dividends. The second one shows that if an agent has a marginal productivity which is strictly greater than land dividend, she will borrow until her borrowing constraints become binding. In other words, this agent needs credit.

The next result suggests that agents with a low productivity do not buy land to produce.

**Proposition 4.** Focus on agent  $i$  and assume that there exists an agent  $j$  such that  $f_j = 1$  and  $F'_i(0) < F'_j(L)$ . Then we have  $l_{i,t} = 0 \forall t$ .

*Proof.* See Appendix B. □

Notice that Proposition 4 holds whatever the form of utility functions and the size of the discount rate  $\beta_i$ .

We can interpret  $f_j = 1$  as a full access of agent  $j$  to credit market. In this case, any agent  $i$  with low productivity (in the sense that  $F'_i(0) < F'_j(L)$ ) never produces. Proposition 4 is in line with Proposition 1 in Le Van and Pham (2016) where they prove that nobody invests in the productive sector if the productivity of this sector is too low.

Agents can be reinterpreted as countries. In this case, our economy works as a world economy with free trade. Each country  $i$  is endowed with  $l_{i,0}$  units of land. When the trade is fully free and the international financial market is good enough (in the sense that  $f_i = 1$  for any  $i$ ), countries with a lower productivity never produce and land in these countries will be held by the countries with the highest productivity.

<sup>7</sup>This condition is satisfied if  $f^i = 1$  or  $a_{i,t-1} > -f_i [q_t l_{i,t-1} + F_i(l_{i,t-1})]$ .

**Remark 2.** When there is lack of commitment (due to financial or political frictions) characterized by  $f_j < 1$ , the analysis becomes more complex. In Section 5.1.1, we will present an example where there are two agents:  $A$  and  $B$  with  $f_A = 0$  (agent  $A$  is prevented from borrowing) with linear technologies. In this example, at date  $2t + 1$ , the productivity of agent  $A$  is higher than that of agent  $B$ , but agent  $B$  may produce at date  $2t + 1$ .

### 3.2 A particular case: a steady state analysis

In this section, we assume that agents have no endowments, that is  $e_{i,t} = 0 \forall i, \forall t$ . For simplicity, we also assume that there are two agents, say  $i$  and  $j$ , with different rates of time preference:  $\beta_i < \beta_j$ .

We give an analysis at the steady state. Recall that when endowments are not stationary, the existence of steady state may not hold.

**Lemma 4.** Consider two agents  $i$  and  $j$  with  $\beta_i < \beta_j$ . If  $e_{i,t} = 0 \forall i, \forall t$ , and  $F_i(l_i) = A_i l_i^\alpha \forall t$ , where  $\alpha \in (0, 1)$ , then there is a unique steady state:

$$r = \beta_j \tag{21}$$

$$q^{\frac{1}{1-\alpha}} L = \left( \frac{\alpha A_i}{\frac{1}{\beta_i + f_i(\beta_j - \beta_i)} - 1} \right)^{\frac{1}{1-\alpha}} + \left( \frac{\alpha A_j}{\frac{1}{\beta_j} - 1} \right)^{\frac{1}{1-\alpha}} \tag{22}$$

$$l_i = \left( \frac{\alpha A_i}{\frac{1}{\beta_i + f_i(\beta_j - \beta_i)} - 1} \frac{1}{q} \right)^{\frac{1}{1-\alpha}}, \quad l_j = L - l_i \tag{23}$$

$$a_i + f_i [q l_i + F_i(l_i)] = 0, \quad a_i + a_j = 0. \tag{24}$$

*Proof.* See Appendix B. □

#### Who will own land in the long run?

Cobb-Douglas technologies imply  $l_i, l_j > 0$ . Each agent holds a strictly positive amount of land to produce themselves. In this respect, our model differs from Becker and Mitra (2012) where the most patient agent holds the entire stock of capital in the long run. The difference rests on two reasons.

First, in Becker and Mitra (2012), the firm is unique and consumers do not produce. In our model, any agent produces with her own technology and can be viewed as a credit-constrained entrepreneur.

Second, in Becker and Mitra (2012), returns on capital are determined by the marginal productivity of their representative firm. In our framework, land dividends are interpreted as land returns and determined by no-arbitrage condition (20).

**Corollary 3** (role of borrowing limit  $f_i$ ). Under conditions in Lemma 4, we have:

1. Price: The relative price of land  $q$  increases in  $f_i$ .
2. Output: The long-run quantity of fruits, i.e.,  $Y := F_i(l_i) + F_j(l_j)$  is increasing in the borrowing limit  $f_i$ .

The intuition of point 1 is that when  $f_i$  increases, agent  $i$  can borrow more and, then, land demand increases in turn raising the price of land at the end.

The point 2 is also intuitive: the higher the level of  $f_i$ , the more the quantity the agent with the highest productivity can borrow, and, finally, the more the output produced.

## 4 Land bubbles

Combining  $Q_{t+1} = \gamma_{t+1}Q_t$  with (20), we get

$$Q_t q_t = Q_{t+1}(q_{t+1} + d_{t+1}) \quad (25)$$

and, so,

$$\begin{aligned} q_0 &= \gamma_1(q_1 + d_1) = Q_1 d_1 + Q_1 q_1 = Q_1 d_1 + Q_1 \gamma_2(q_2 + d_2) = Q_1 d_1 + Q_2 d_2 + Q_2 q_2 \\ &= \dots = \sum_{t=1}^T Q_t d_t + Q_T q_T \forall T \geq 1. \end{aligned} \quad (26)$$

This leads the following definition.

**Definition 3** (bubble). *The fundamental value of land is defined by  $FV_0 := \sum_{t=1}^{\infty} Q_t d_t$ . We say that a land bubble exists if the market price of land (in term of consumption good) exceeds its fundamental value:  $q_0 > FV_0$ .*

As seen above, land dividends capture a twofold role of land: land is used to produce a consumption good and, as collateral, to borrow. The fundamental value of land reflects the value of these roles.

As in [Montrucchio \(2004\)](#), [Le Van and Pham \(2014\)](#), some equivalences hold.

**Proposition 5** (Necessary and sufficient conditions for the existence of bubbles). *A land bubble exists (i.e.,  $\lim_{t \rightarrow \infty} Q_t q_t > 0$ ) if and only if  $\sum_{t=1}^{\infty} (d_t/q_t) < +\infty$ .*

*Proof.* See Appendix C. □

Note that this result only depends on the no-arbitrage condition (25). Proposition 5 holds for any form of technologies, even non-stationary.

Since we are assuming that technologies are stationary, we have  $d_t \geq \min_i F'_i(l_{i,t-1}) \geq \min_i F'_i(L) > 0 \forall t$ . This leads the following result.

**Corollary 4.** *If a land bubble exists, then  $\sum_{t=1}^{\infty} (1/q_t) < +\infty$ .*

This explains why the existence of land bubble implies that real land prices tend to infinity. Notice, however, that this fact only holds in the case of stationary technology. In Section 5.1.1, this issue will be readdressed.

**Interest rates, asset prices and bubbles.** According to (26), we have  $\sum_{t=1}^{\infty} Q_t d_t \leq q_0 < \infty$  and, also,  $d_t \geq \min_i F'_i(l_{i,t-1}) \geq \min_i F'_i(L) > 0 \forall t$ . Eventually, we get  $\sum_{t=1}^{\infty} Q_t < \infty$ .

We introduce the real interest rate of the economy  $\rho_t$  at date  $t$  as follows:  $\gamma_t = 1/(1 + \rho_t)$ . We notice that  $\rho_t$  may be negative. The condition  $\sum_{t=1}^{\infty} Q_t < \infty$  writes explicitly

$$\sum_{t=0}^{\infty} \frac{1}{\prod_{s=1}^t (1 + \rho_s)} < \infty$$

and we can reinterpret it by saying that the real interest rates are not "too low". We also observe that there exists a sequence of dates  $(t_n)_n$  such that  $\rho_{t_n} > 0$  for all  $n$ .

According to Proposition 5, a land bubble exists if and only if  $\lim_{t \rightarrow \infty} \frac{1}{\prod_{s=1}^t (1 + \rho_s)} q_t > 0$ .

This condition implies in turn  $\lim_{t \rightarrow \infty} \frac{q_{t+1}}{q_t} \frac{1}{1 + \rho_{t+1}} = 1$ . Hence, in the long run, if a land bubble exists, the rate of growth of land prices is equal to the gross interest rate.

## 4.1 No-bubble results

**Proposition 6.** *If  $Q_t/Q_{i,t}$  is uniformly bounded from above for all  $i$ , then there is no bubble.*

*Proof.* See Appendix C. □

Write  $\gamma_{i,t} = 1/(1 + \rho_{i,t})$ , where  $\rho_{i,t}$  is interpreted as the the real expected interest rate of agent  $i$  at date  $t$ . As above, this interest rate may be negative. According to Proposition 6, if a bubble exists, there is an agent  $i$  such that her expected interest rates are high with respect to those of the economy in the following sense:

$$\prod_{s=1}^T \frac{1 + \rho_{i,t}}{1 + \rho_t} \xrightarrow{T \rightarrow \infty} \infty$$

Let us point out some consequences of Proposition 6.

**Corollary 5.** *If there exists  $T > 0$  such that  $\mu_{i,t} = 0 \forall i, \forall t \geq T$ , then there is no land bubble.*

*Proof.* See Appendix C. □

The intuition of this result is that when  $\mu_{i,t} = 0 \forall i, \forall t \geq T$ , the individual discount factors coincide with the discount factors of the economy. In this case, the no-bubble condition turns out to be equivalent to the no-Ponzi scheme. Since the transversality conditions are satisfied, the no-bubble condition holds as well.

Corollary 5 implies that if the borrowing constraints of any agent are not binding, then, there is no bubble. The following corollary clarifies it in other words.

**Corollary 6** (bubble existence and borrowing constraints). *If a land bubble exists, there exist an agent  $i$  and an infinite sequence of dates  $(t_n)_n$  such that the borrowing constraints of agent  $i$  are binding at each date  $t_n$ , that is, for all  $t_n$ ,*

$$a_{i,t_n-1} = -f_i[q_{t_n} l_{i,t_n-1} + F_i(l_{i,t_n-1})]$$

**Remark 3.** *The binding of borrowing constraints is only a necessary condition for the existence of bubble. Sections 5.1.1 and 5.2 provide some examples where borrowing constraints of any agent are frequently binding but bubble may not exist.*

*The relationship between the existence of bubble and borrowing constraints is questioned in Kocherlakota (1992). He considers borrowing constraints:  $x_{i,t} \geq x$ , where  $x_{i,t}$  is the asset quantity held by agent  $i$  at date  $t$  and  $x \leq 0$  is an exogenous bound. He claims that  $\liminf_{t \rightarrow \infty} (x_{i,t} - x) = 0$  and interprets that borrowing constraints of agent  $i$  are frequently binding. He did not proved that  $x_{i,t} - x = 0$  frequently.*

We define the aggregate output of the economy at date  $t$  as  $Y_t := \sum_{i=1}^m [e_{i,t} + F_i(l_{i,t-1})]$  and the present value of the aggregate output as  $\sum_{t=0}^{\infty} Q_t Y_t$ .

The main result of the section rests on the following list of four lemmas whose proofs are gathered in Appendix C.

**Lemma 5.** *If  $\sup_{i,t} e_{i,t} < \infty$  and technologies are stationary, the present value of the aggregate output is finite.*

**Lemma 6.** *Assume that  $\sup_{i,t} e_{i,t} < \infty$  and technologies be stationary. Given an equilibrium, we obtain that  $Q_t(l_{i,t} q_t + r_t a_{i,t})$  is uniformly bounded from below and from above as well.*

**Lemma 7.** Let  $\sup_{i,t} e_{i,t} < \infty$  and technologies be stationary. Given an equilibrium, the following limits exist:

$$\lim_{t \rightarrow \infty} Q_t(q_t l_{i,t} + r_t a_{i,t}) = \lim_{t \rightarrow \infty} (Q_t q_t l_{i,t-1} + Q_t a_{i,t-1}) \quad \forall i. \quad (27)$$

**Lemma 8.** Let  $\sup_{i,t} e_{i,t} < \infty$  and technologies be stationary. Given an equilibrium, if there exists  $T$  such that

$$f_i\left(q_t + \frac{F_i(l_{i,t-1})}{l_{i,t-1}}\right) l_{i,t-1} \geq (q_t + d_t) l_{i,t-1} \quad \forall t \geq T, \quad (28)$$

then  $\lim_{t \rightarrow \infty} Q_t(q_t l_{i,t} + r_t a_{i,t}) \leq 0$ .

Let us now state the main result of this section.

**Proposition 7.** Assume that  $\sup_{i,t} e_{i,t} < \infty$  and  $f_i = 1 \quad \forall i$ . We also assume that all technologies be stationary and not zero. Then, there is no land bubble at equilibrium.

*Proof.* See Appendix C. □

This proposition points out that there is no land bubble at equilibrium when the financial system is good enough (in the sense that  $f_i = 1 \quad \forall i$ ), exogenous endowments are bounded from above and the technology is stationary.

Proposition 7 suggests that land bubbles only appear when TFP of land technologies tends to zero or/and endowments grow without bound or/and agents cannot easily enter the financial market ( $f_i < 1$ ). In Section 5, we will present some examples of bubbles, where these conditions are violated.

Proposition 7 is in line with the results in Kocherlakota (1992), Santos and Woodford (1997), Huang and Werner (2000) and Le Van and Pham (2014), where they prove that bubbles are ruled out if the present value of aggregate endowments is finite. Indeed, the asset in Kocherlakota (1992) is a particular case of land in our model when  $F_{i,t}(X) = \xi_t X \quad \forall i, \forall X$ . Proposition 7 also shows that land bubbles are ruled out in Kiyotaki and Moore (1997).

**Remark 4.** 1. Proposition 7 still holds for any technology in the form  $A_{i,t} F_i$  where  $A_{i,t}$  is bounded away from zero for any  $i$ .

2. Interestingly, although we are considering the utility function  $\sum_t \beta_i^t u_i(c_{i,t})$ , our proof of Proposition 7 still works in more general cases (for example, when the utility function takes the form  $\sum_t u_{i,t}(c_{i,t})$ ).<sup>8</sup>

## 4.2 Alternative concepts: individual and strong bubbles

According to (11), we have

$$\begin{aligned} q_t &= \frac{\lambda_{i,t+1} + f_i \mu_{i,t+1}}{\lambda_{i,t}} (q_{t+1} + F'_i(l_{i,t})) + \frac{\eta_{i,t}}{\lambda_{i,t}} \\ &= \frac{\lambda_{i,t+1}}{\lambda_{i,t}} \underbrace{\left( q_{t+1} + F'_i(l_{i,t}) \right)}_{\text{Production return}} + \frac{\eta_{i,t}}{\lambda_{i,t+1}} + \underbrace{\frac{f_i \mu_{i,t+1}}{\lambda_{i,t+1}} (q_{t+1} + F'_i(l_{i,t}))}_{\text{Collateral return}} \end{aligned}$$

<sup>8</sup>It should be noticed that our method here is no longer suitable for stochastic economies with incomplete markets. This issue will be addressed in Section 6.2.2.

We rewrite

$$q_t = \gamma_{i,t+1}(q_{t+1} + d_{i,t+1}) \quad (29)$$

and call  $d_{i,t+1}$  the individual dividend of agent  $i$  at date  $t+1$ . Here  $d_{i,t+1}$  includes two terms. The first one is  $X_{i,t+1} := F'_i(l_{i,t}) + \frac{\eta_{i,t}}{\lambda_{i,t+1}}$  which represents the return from the production process.<sup>9</sup> The second term  $\frac{f_i \mu_{i,t+1}}{\lambda_{i,t+1}}(q_{t+1} + F'_i(l_{i,t}))$  can be interpreted as a collateral return. Note that the collateral return is equal to zero if  $f_i = 0$  or  $\mu_{i,t+1} = 0$  (happen if borrowing constraint is not binding).

The asset-pricing equation (29) shows the way agent  $i$  evaluates the price of land. With the individual discount factor  $\gamma_{i,t+1}$ , once agent  $i$  buys land, she will be able to resell land at a price  $q_{t+1}$  and she will expect to receive  $d_{i,t+1}$  units of consumption good as dividends. Since the individual discount factor  $\gamma_{i,t+1}$  is less than that of economy  $\gamma_{t+1}$ , the individual dividend  $d_{i,t+1}$  expected by agent  $i$  exceeds the dividend  $d_{t+1}$  of the economy.

Using (29) and adopting the same argument in (26), we find that, for all  $T \geq 1$ ,

$$q_0 = \sum_{t=1}^T Q_{i,t} d_{i,t} + Q_{i,T} q_T$$

**Definition 4** (individual bubble). 1.  $FV_i := \sum_{t=1}^{\infty} Q_{i,t} d_{i,t}$  is the  $i$ -fundamental value of land. We say that a  $i$ -land bubble exists if  $q_0 > \sum_{t=1}^{\infty} Q_{i,t} d_{i,t}$ .

2. A strong bubble exists if the asset price exceeds any individual value of land, that is  $q_0 > \max_i FV_i \forall i$ .

The concept of  $i$ -bubble is closely related to bubbles of durable goods and collateralized assets in Araujo et al. (2011) or bubble of fiat money in Pascoa et al. (2011). Given an equilibrium, Araujo et al. (2011) provide asset-pricing conditions (Corollary 1, page 263) based on the existence of what they call *deflators* and *non-pecuniary returns* which are not necessarily unique. Then, they define bubble associated to each deflators and non-pecuniary returns. In our framework, for each equilibrium, we give closed formulas for two types of deflators (we call  $\gamma_t$  and  $\gamma_{i,t}$  discount factor and individual discount factor respectively). Unlike Araujo et al. (2011), the technology in our paper may be non-linear and non-stationary.

By applying the same argument in Proposition 5, we obtain some equivalences.

**Proposition 8.** An  $i$ -land bubble exists (i.e.,  $\lim_{t \rightarrow \infty} Q_{i,t} q_t > 0$ ) if and only if  $\sum_{t=1}^{\infty} (d_{i,t}/q_t) < +\infty$ .

Another added-value of our paper (comparing with Araujo et al. (2011), Pascoa et al. (2011)) is to study the connection between the concepts of bubble and  $i$ -bubble. This is showed in the following result.

**Proposition 9.** We have that:

1.  $FV_0 \leq FV_i \leq q_0 \forall i$ . By consequence, if an  $i$ -land bubble exists for some agent  $i$ , then a land bubble exists.
2. There is an agent  $i$  such that her  $i$ -bubble is ruled out. Consequently, there is no strong land bubble, that is  $q_0 = \max_i FV_i$ .

---

<sup>9</sup>Note that  $X_{i,t+1} l_{i,t} = F'_i(l_{i,t}) l_{i,t}$ .

3. If  $FV_0 = FV_i \forall i$ , then  $FV_0 = FV_i = q_0 \forall i$ , that is, there is no room for bubble nor  $i$ -bubble.

*Proof.* See Appendix C. □

**Comments and discussions.**  $FV_0 \leq FV_i \leq q_0$  follows from the definitions of bubble and  $i$ -bubble. The intuition is that, since any agent expects a higher interest rate than that of the economy, the individual value of land expected by any agent will exceed the fundamental value of land. Nevertheless, the converse of point 1 may not be true. In Section 5.1.1, we present an example where  $i$ -bubble does not exist for all  $i$  while land bubble may arise.

Points 2 shows that there is an agent whose expected value of land equals its equilibrium price. Point 3 is more intuitive and complements point 2: when any individual value of land coincides with that of economy, both land and individual bubbles are ruled out. However, when any individual value of land is identical but different from the fundamental value of land, we do not know whether land bubbles are ruled out.<sup>10</sup>

Our concept of strong bubble is related to the notion of *speculative bubble* in Werner (2014). He considers an asset bringing exogenous dividends in a model with ambiguity. Werner (2014) defines the asset fundamental value under the beliefs of agent  $i$  as the sum of discounted expected future dividends under her beliefs. He then says that speculative bubble exists if the asset price is strictly higher than any agent's fundamental value. The readers may ask why strong bubbles are ruled out while speculative bubbles in Werner (2014) may exist. It is hard to compare these two results since the two concepts of bubbles are defined in two different settings (with and without ambiguity).

**Remark 5.** It should be noticed that Proposition 9 still holds in more general cases (for example, when the utility function is  $\sum_t u_{i,t}(c_{i,t})$ ).

## 5 Examples of bubbles

In this section, we contribute to the literature of rational bubbles by providing some examples where bubbles appear in deterministic economies even short-sales are allowed.<sup>11</sup> Notice that dividends are endogenous determined and may be strictly positive.

### 5.1 Land bubbles without financial market

Focus on the case where there is no financial market. In this section, we allow for non-stationary production functions. Let us rewrite agents' program. The household  $i$  takes the sequence of land prices  $(q) = (q_t)_{t=0}^{\infty}$  as given and chooses sequences of consumption and land  $(c_i, l_i) := (c_{i,t}, l_{i,t})_{t=0}^{+\infty}$  in order to maximize her intertemporal utility

$$P_i(q) : \max \sum_{t=0}^{+\infty} \beta_i^t u_i(c_{i,t})$$

$$\text{subject to, for all } t \geq 0, : l_{i,t} \geq 0, \quad c_{i,t} + q_t l_{i,t} \leq e_{i,t} + q_t l_{i,t-1} + F_{i,t}(l_{i,t-1}), \quad (30)$$

where  $l_{i,-1} > 0$  is given.

<sup>10</sup>See observation "1. bubble vs  $i$ -bubble" in Section 5.1.1.

<sup>11</sup>Araujo et al. (2011) provide some examples of equilibria with bubbles in models where the utility functions take the form  $\sum_{t \geq 0} \zeta_{i,t} u(c_{i,t}) + \epsilon_i \inf_{t \geq 0} u_i(c_{i,t})$ . The parameter  $\epsilon_i$  plays the key role on the existence of bubbles.



Under a linear technology ( $F_{i,t}(x) = \xi_t x \forall i$ ), the land structure becomes the same asset structure as in [Kocherlakota \(1992\)](#), and [Huang and Werner \(2000\)](#). If  $F_i = 0 \forall i$ , land becomes a pure bubble as in [Tirole \(1985\)](#).

**Definition 5.** A list  $(\bar{q}_t, (\bar{c}_{i,t}, \bar{l}_{i,t})_{i=1}^m)_{t=0}^{+\infty}$  is an equilibrium of the economy without financial market if the following conditions hold.

(i)  $\bar{q}_t \in (0, \infty) \forall t \geq 0$ .

(ii) Market clearing: for all  $t \geq 0$ ,

$$\sum_{i=1}^m \bar{c}_{i,t} = \sum_{i=1}^m (e_{i,t} + F_{i,t}(\bar{l}_{i,t-1})), \quad \sum_{i=1}^m \bar{l}_{i,t} = L.$$

(iii) Agents' optimality: for all  $i$ ,  $(\bar{c}_{i,t}, \bar{l}_{i,t})_{t=0}^{\infty}$  is a solution of the problem  $P_i(\bar{q})$ .

**Remark 6.** By applying [Proposition 1](#) and [Lemma 9 \(Appendix D\)](#), we can check that an equilibrium for the economy without financial market is a part of an equilibrium for the economy  $\mathcal{E}$  with  $f_i = 0 \forall i$ .

Let  $(q, (c_i, l_i)_{i=1}^m)$  be an equilibrium. Denoting by  $\lambda_{i,t}$  and  $\mu_{i,t}$  the multipliers associated to the budget constraint [\(30\)](#) of agent  $i$  and to the borrowing constraint  $l_{i,t} \geq 0$ , we obtain the following FOCs:

$$\begin{aligned} \beta_i^t u'_i(c_{i,t}) &= \lambda_{i,t} \\ \lambda_{i,t} q_t &= \lambda_{i,t+1} (q_{t+1} + F'_{i,t+1}(l_{i,t})) + \eta_{i,t}, \quad \eta_{i,t} l_{i,t} = 0. \end{aligned}$$

As above, we introduce the dividends of land:  $q_t = \gamma_{t+1} (q_{t+1} + d_{t+1})$ , where  $\gamma_{t+1}$  is the discount factor of the economy from date  $t$  to date  $t+1$ :  $\gamma_{t+1} := \max_{i \in \{1, \dots, m\}} \frac{\beta_i u'_i(c_{i,t+1})}{u'_i(c_{i,t})}$ .

We define the discount factor of the economy from initial date to date  $t$  as follows:  $Q_0 := 1$  and  $Q_t := \prod_{s=1}^t \gamma_s$  for any  $t \geq 1$ . Then, the fundamental value of the land is defined by  $FV_0 := \sum_{t=1}^{\infty} Q_t d_t$ . We say that a land bubble exists if  $q_0 > FV_0$ .

### 5.1.1 Examples of land bubbles

We now construct equilibria with bubbles.

**The economy's fundamentals.** Assume that there are two agents ( $A$  and  $B$ ) with a common utility function  $u_A(x) = u_B(x) = \ln(x)$  but different non-stationary technologies  $F_{A,t}(X) = A_t X, F_{B,t}(X) = B_t X$ . For the sake of simplicity, we normalize the supply of land to one:  $L = 1$ . We assume that  $e_{A,2t} = e_{B,2t+1} = 0 \forall t$ .

We need the following conditions to ensure the FOCs and identify the sequence of discount factors of the economy  $(\gamma_t)$ .

$$\beta_A \left( \frac{\beta_B e_{B,2t}}{1 + \beta_B} + A_{2t} \right) \left( \frac{\beta_A e_{A,2t+1}}{1 + \beta_A} + A_{2t+1} \right) \leq \beta_B \frac{e_{B,2t}}{1 + \beta_B} \frac{e_{A,2t+1}}{1 + \beta_A} \quad (31)$$

$$\beta_B \left( \frac{\beta_A e_{A,2t-1}}{1 + \beta_A} + B_{2t-1} \right) \left( \frac{\beta_B e_{B,2t}}{1 + \beta_B} + B_{2t} \right) \leq \beta_A \frac{e_{B,2t}}{1 + \beta_B} \frac{e_{A,2t-1}}{1 + \beta_A} \quad (32)$$

$$\beta_A \left( \frac{\beta_B e_{B,2t}}{1 + \beta_B} + A_{2t} \right) \left( \frac{\beta_A e_{A,2t+1}}{1 + \beta_A} + B_{2t+1} \right) \leq \beta_B \frac{e_{B,2t}}{1 + \beta_B} \frac{e_{A,2t+1}}{1 + \beta_A} \quad (33)$$

$$\beta_B \left( \frac{\beta_A e_{A,2t-1}}{1 + \beta_A} + B_{2t-1} \right) \left( \frac{\beta_B e_{B,2t}}{1 + \beta_B} + A_{2t} \right) \leq \beta_A \frac{e_{B,2t}}{1 + \beta_B} \frac{e_{A,2t-1}}{1 + \beta_A}. \quad (34)$$

These conditions are not too demanding and are satisfied if, for instance,  $\beta_A = \beta_B = \beta$ ,

$$\max(A_{2t}, B_{2t}) < \frac{(1-\beta)e_{B,2t}}{1+\beta} \text{ and } \max(A_{2t+1}, B_{2t+1}) < \frac{(1-\beta)e_{A,2t+1}}{1+\beta} \quad \forall t.$$

**Equilibrium.** In Appendix D, we compute the equilibrium allocations.

$$l_{A,2t-1} = L, l_{A,2t} = 0, \quad l_{B,2t-1} = 0, l_{B,2t} = L \quad (35)$$

$$c_{A,2t} = q_{2t}L + A_{2t}L, \quad c_{B,2t} + q_{2t}L = e_{B,2t} \quad (36)$$

$$c_{A,2t+1} + q_{2t+1}L = e_{A,2t+1}, \quad c_{B,2t+1} = q_{2t+1}L + B_{2t+1}L \quad (37)$$

as well the equilibrium prices

$$q_{2t} = \frac{\beta_B}{1+\beta_B}e_{B,2t} \text{ and } q_{2t+1} = \frac{\beta_A}{1+\beta_A}e_{A,2t+1} \quad \forall t \geq 0.$$

We find also the discount factors and the land dividends

$$\gamma_{2t} = \frac{\beta_A u'_A(c_{A,2t})}{u'_A(c_{A,2t-1})} \text{ and } \gamma_{2t+1} = \frac{\beta_B u'_B(c_{B,2t+1})}{u'_B(c_{B,2t})} \quad \forall t \geq 0 \quad (38)$$

$$d_{2t} = A_{2t} \text{ and } d_{2t+1} = B_{2t+1} \quad \forall t \geq 0. \quad (39)$$

According to Proposition 5, a land bubble exists if and only if  $\sum_{t=0}^{\infty} d_t/q_t < \infty$ , i.e.,

$$\sum_{t=0}^{\infty} \frac{A_{2t}}{e_{B,2t}} + \sum_{t=0}^{\infty} \frac{B_{2t+1}}{e_{A,2t+1}} < \infty$$

**Intuition.** This condition may be interpreted that land dividends are low with respect to endowments. This implies that the existence of bubble requires low dividends. Let us explain the intuition. In the odd periods  $(2t+1)$ , agent  $B$  has no endowments. She wants to smooth consumption over time according to her logarithm utility (which satisfies the Inada conditions), but she cannot transfer her wealth from future to this date.<sup>12</sup> By consequence, she accepts to buy land at a higher price:  $q_{2t} \geq e_{B,2t}\beta_B/(1+\beta_B)$ , independently on agents' productivity. A lower productivity implies lower dividends and a lower fundamental value of land. As long as dividends tend to zero, the land price remains higher than this fundamental value.

We point out some particular cases of our example.

**Example 1** (land bubble with endowment growth). *Consider our example and assume that  $A_t = B_t = A \forall t$ . Then a land bubble exists if and only if*

$$\sum_{t=0}^{\infty} \frac{1}{e_{B,2t}} + \sum_{t=0}^{\infty} \frac{1}{e_{A,2t+1}} < \infty$$

Example 1 illustrates Proposition 7. Thus, under a common stationary production function and  $f_i = 0 \forall i$ , land bubbles may appear if endowments tend to infinity. In this example, we see that a land bubble arises if and only if  $\sum_{t=1}^{\infty} 1/q_t < \infty$ . By the way, this result also illustrates Corollary 4.

**Example 2** (land bubble with collapsing land technologies). *Reconsider our example. If  $e_{A,2t+1} = e_{B,2t} = e > 0 \forall t$ , then a land bubble emerges if and only if  $\sum_{t=0}^{\infty} (A_{2t} + B_{2t+1}) < \infty$ .*

<sup>12</sup>Because she is prevented from borrowing.

This result is also related to [Bosi et al. \(2017a\)](#) where they show that bubbles in aggregate good arise if the sum of capital returns is finite.

Some interesting remarks deserve mention.

1. **Bubble vs  $i$ -bubble.** Since  $\lim_{t \rightarrow \infty} \beta_i^t u'_i(c_{i,t}) q_t = 0$  for  $i = A, B$ , there does not exist no  $i$ -bubble for  $i = A, B$ . However, a land bubble may occur. In this case, any individual value of land is identical and equal to the equilibrium price but it may exceed the fundamental value of land.
2.  **$i$ -bubble and borrowing constraints.** In the above example, borrowing constraints of both agents are binding at infinitely many dates while every individual bubbles are ruled out and land bubbles may or may not appear. This shows that the values of (individual) bubbles are not the shadow prices of binding borrowing constraints.
3. **Pure bubble (or fiat money).** We consider a particular case: If  $A_t = B_t = 0 \forall t$ . In this case, the fundamental value of land is zero and an equilibrium is bubbly if the prices of land are strictly positive in any period ( $q_t > 0 \forall t$ ). This bubble is called *pure bubble* ([Tirole, 1985](#)). Our example shows that equilibria with pure bubble may exist in infinite-horizon general equilibrium models.

In this case, the land in our model can be interpreted as *fiat money* in [Bewley \(1980\)](#), [Santos and Woodford \(1997\)](#), [Pascoa et al. \(2011\)](#) where they provide some examples where the fiat money price is strictly positive. Our contribution concerns the existence of bubble of assets with positive and endogenous dividends.

4. **Land bubbles vs monotonicity of prices.** Corollary 4 points out that, under stationary technologies, the existence of land bubble entails the divergence of land prices to infinity. However, in our example with non-stationary technologies, the land prices are given by

$$q_{2t} = \frac{\beta_B}{1 + \beta_B} e_{B,2t} \text{ and } q_{2t+1} = \frac{\beta_A}{1 + \beta_A} e_{A,2t+1}$$

and we see that land prices may either increase or decrease or fluctuate over time whenever bubbles exist. Our result generalizes that of [Weil \(1990\)](#) where he gives an example of bubble with decreasing asset prices. His model is a particular case of ours when land gives no longer fruits from some date on: there exists  $T$  such that  $A_t = B_t = 0 \forall t \geq T$ .

5. **Do the most productive agents produce?** In the above examples, although agents have linear production functions, these functions are different.

There is a case where the productivity of agent  $A$  is higher than that of agent  $B$ , i.e.,  $A_{2t+1} > B_{2t+1}$ , but agent  $A$  does not produce at date  $2t + 1$  while agent  $B$  produce at this date. For two reasons: (1) agents are prevented from borrowing, (2) agents' endowments change over time. Although  $A$  has a higher productivity at date  $2t + 1$ , she has also a higher endowment at this date, but no endowment at date  $2t$ . So, she may not need to buy land at date  $2t$  to produce and transfer wealth from date  $2t$  to date  $2t + 1$ . Instead, she sells land at date  $2t$  to buy and consume consumption good at date  $2t$ . Therefore, agent  $A$  may not produce at date  $2t + 1$  even  $A_{2t+1} > B_{2t+1}$ .

Using similar methods, we may construct other examples of bubbles with non-linear production functions, for example  $F_{i,t}(x) = A_{i,t} \ln(1 + x)$  where  $A_{i,t} \geq 0$ . Notice that [Bosi](#)

et al. (2018) consider an OLG model with non-linear production functions, including Cobb-Douglas technology, and provide some examples of bubbles, where equilibrium indeterminacy may arise.

### 5.1.2 Example of individual land bubbles

**The economy's fundamentals.** Consider the example in Section 5.1.1. For the sake of simplicity, we assume that  $\beta_A = \beta_B =: \beta$ .

We add the third agent: agent  $D$ . The utility, the rate of time preference, and the technologies of agent  $D$  are:  $u_D(c) = \ln(c)$ ,  $\beta_D = \beta$ ,  $F_{D,t}(L) = D_t L$ .

The endowments  $(e_{D,t})_t$  and productivities  $(D_t)$  of agents  $D$  are defined by

$$\frac{\beta e_{D,t}}{e_{D,t+1}} = \frac{q_t}{q_{t+1} + D_{t+1}} = \gamma_{t+1}$$

where  $(\gamma_t)$  is determined as in Section 5.1.1. We see that such sequences  $(e_{D,t})_t$  and  $(D_t)$  exist. Indeed, for example, we choose  $D_t = d_t$  where  $d_t$  is determined as in (39). Then, we choose  $(e_{D,t})_t$  such that  $\beta e_{D,t} = \gamma_{t+1} e_{D,t+1}$ .

**Equilibrium:** Prices and allocations of agents  $A$  and  $B$  are as in Section 5.1.1. The allocations of agent  $D$  are  $c_{D,t} = e_{D,t}$  and  $l_{D,t} = 0 \forall t$ . By using the same argument in Section 5.1.1, it is easy to verify that this system of prices and allocations constitutes an equilibrium.

We observe that agent  $D$  does not trade and  $\gamma_{D,t} = \beta e_{D,t-1}/e_{D,t} = \gamma_t \forall t$ . By consequence,  $\lim_{t \rightarrow \infty} Q_{D,t} q_t = \lim_{t \rightarrow \infty} Q_t q_t > 0$ . There is a  $D$ -bubble, i.e. the equilibrium price of land is strictly higher than the individual value of land with respect to agent  $D$ .

## 5.2 Land bubbles with short-sales

We now provide examples of bubbles when short-sales are allowed. These new examples particularly contribute to the novelty of our paper.

**The economy's fundamentals.** Assume that there are two agents ( $A$  and  $B$ ) with a common utility function  $u_A(x) = u_B(x) = \ln(x)$  but different non-stationary technologies:  $F_{A,t}(X) = A_t X$ ,  $F_{B,t}(X) = B_t X$  with

$$B_{2t} \geq A_{2t}, \quad A_{2t+1} \geq B_{2t+1} \quad \forall t.$$

The supply of land is  $L = 1$ . Borrowing limits are  $f_A = f_B = 1$ . For simplicity, we assume that  $\beta_A = \beta_B = \beta \in (0, 1)$ . Applying Proposition 1 allows us obtain the following result.

**Example 3** (land bubbles with short-sales). *Let endowments be given by*<sup>13</sup>

$$\begin{aligned} e_{B,2t-1} &= e_{A,2t} = 0 \quad \forall t \geq 1 \\ \frac{e_{B,2t} e_{A,2t+1}}{(1+\beta)^2} &> \left( \frac{\beta}{1+\beta} e_{B,2t} + B_{2t} \right) \left( \frac{\beta}{1+\beta} e_{A,2t+1} + A_{2t+1} \right) \quad \forall t \geq 0 \\ \frac{e_{B,2t} e_{A,2t-1}}{(1+\beta)^2} &> \left( \frac{\beta}{1+\beta} e_{B,2t} + B_{2t} \right) \left( \frac{\beta}{1+\beta} e_{A,2t-1} + A_{2t-1} \right) \quad \forall t \geq 1. \end{aligned}$$

*Equilibrium prices are determined as follows:*

$$\begin{aligned} q_0 &= \beta(e_{B,0} + B_0), \quad q_{2t} = \frac{\beta}{1+\beta} e_{B,2t} \quad \forall t \geq 0, \quad q_{2t-1} = \frac{\beta}{1+\beta} e_{A,2t-1} \quad \forall t \geq 1, \\ \frac{1}{r_{2t-1}} &= \frac{q_{2t} + B_{2t}}{q_{2t-1}} \quad \forall t \geq 1, \quad \frac{1}{r_{2t-2}} = \frac{q_{2t-1} + A_{2t-1}}{q_{2t-2}} \quad \forall t \geq 1. \end{aligned}$$

<sup>13</sup>These conditions are similar to (31, 32, 33, 34) in our example of bubble in models without short-sales.

Allocations are determined by

$$(l_{A,2t-1}, l_{B,2t-1}) = (0, 1), \quad (l_{A,2t}, l_{B,2t}) = (1, 0) \quad (40)$$

$$a_{A,2t-1} = q_{2t} + B_{2t} = -a_{B,2t-1}, \quad a_{B,2t} = q_{2t+1} + A_{2t+1} = -a_{A,2t} \quad \forall t \geq 1. \quad (41)$$

Dividends are calculated by

$$d_{2t} = B_{2t} \text{ and } d_{2t+1} = A_{2t+1} \quad \forall t \geq 0. \quad (42)$$

According to Proposition 5, a land bubble exists if and only if

$$\sum_{t=1}^{\infty} \frac{B_{2t}}{e_{B,2t}} + \sum_{t=0}^{\infty} \frac{A_{2t+1}}{e_{A,2t+1}} < \infty. \quad (43)$$

As in economies without-short sales, a bubble may occur if endowments growth without bound and/or TFP tends to zero.

**The intuition** of our example: Look at the economy at date  $2t$ . Agent  $B$  knows that she will not have endowment at date  $2t + 1$ :  $e_{B,2t+1} = 0$ , and hence she wants to transfer her wealth from date  $2t$  to date  $2t + 1$  (she saves at date  $2t$ ). Therefore, she may accept to buy land with a high price or buy financial asset with low interest rates. The same argument applies for the agent  $A$  at date  $2t + 1$ . Therefore, the price of land may be higher than its fundamental value or equivalently the bubble component  $\lim_{t \rightarrow \infty} Q_t q_t$  may be strictly positive.

Some observations should be mentioned.

1. **Dividends are endogenous.** Comparing our example in this section and that in Section 5.1.1, the technologies of two agents  $A$  and  $B$  do not change but land dividends change (see (39) and (42)). This difference is from the fact that land dividends are endogenous defined.
2. **With vs without short-sales.** In Examples without short-sale in Section 5.1.1, agents transfer their wealth from one date to the next date by the unique way: buying land. However, in Example 3, they do so by investing in the financial market or buying land. Thanks to the financial market, land is used by the most productive agent in Example 3. This is not true when agents are prevented from borrowing as showed in Section 5.1.1.

## 6 Extension: a stochastic model

In this section, we will extend our analysis to the stochastic case and discuss the land valuation.

### 6.1 Framework and basic properties

In this section, we present a stochastic model which is based on the deterministic model in Section 2 and that in the literature of infinite-horizon incomplete markets as Magill and Quinzii (1994), Magill and Quinzii (1996), Kubler and Schmedders (2003), Magill and Quinzii (2008) and references therein, or more recently Araujo et al. (2011), Pascoa et al. (2011).

Consider an infinite-horizon discrete time economy where the set of dates is  $0, 1, \dots$  and there is no uncertainty at initial date ( $t = 0$ ). Given a history of realizations of the states

of nature for the first  $t - 1$  dates, with  $t \geq 1$ ,  $\bar{s}_t = (s_0, \dots, s_{t-1})$ , there is a finite set  $\mathcal{S}(\bar{s}_t)$  of states that may occur at date  $t$ . A vector  $\xi = (t, \bar{s}_t, s)$ , where  $t \geq 1$  and  $s \in \mathcal{S}(\bar{s}_t)$ , is called a *node*. The only node at  $t = 0$  is denoted by  $\xi_0$ . Let  $\mathcal{D}$  be the (countable) event-tree, i.e., the set of all nodes. We denote by  $t(\xi)$  the date associated with a node  $\xi$ .

Given  $\xi := (t, \bar{s}_t, s)$  and  $\mu := (t', \bar{s}_{t'}, s')$ , we say that  $\mu$  is a successor of  $\xi$ , and we write  $\mu > \xi$ , if  $t' > t$  and the first  $t + 1$  coordinates of  $\bar{s}_{t'}$  are  $(\bar{s}_t, s)$ . We write  $\mu \geq \xi$  to say that either  $\mu > \xi$  or  $\mu = \xi$ .

For each  $T$  and  $\xi$ , we denote  $D(\xi) := \{\mu : \mu \geq \xi\}$  the sub-tree with root  $\xi$ ;  $D_T := \{\xi : t(\xi) = T\}$  the family of nodes with date  $T$ ;  $D^T(\xi) := \bigcup_{t=t(\xi)}^T D_t(\xi)$ , where  $D_T(\xi) := D_T \cap D(\xi)$ ;  $D^T := D^T(\xi_0)$ ;  $\xi^+ := \{\mu \geq \xi : t(\mu) = t(\xi) + 1\}$  the set of immediate successors of  $\xi$ ;  $\xi^-$  the unique predecessor of  $\xi$ .

There is a single consumption good (which is set to be the numéraire) at each node.  $I = \{1, 2, \dots, m\}$  denotes the set of agents. At each node  $\xi$ , each agent  $i$  is endowed  $e_{i,\xi} > 0$  units of consumption good.

There is a single short-lived asset that can be traded at any node. Each unit of asset purchased at node  $\xi$  is a claim to the contingent vector  $(R_{\xi'})_{\xi' \in \xi^+}$  of positive real dividends in units of the consumption good. To simplify the presentation, consider the simple case where the dividends are non-risky, i.e.,  $R_{\xi'} = 1 \forall \xi'$ .

Each household  $i$  takes the sequence of prices  $(q, r) := (q_\xi, r_\xi)_{\xi \in \mathcal{D}}$  as given and chooses sequences of consumption, land, and asset volume  $(c_i, l_i, a_i) := (c_{i,\xi}, l_{i,\xi}, a_{i,\xi})_{\xi \in \mathcal{D}}$  in order to maximize her intertemporal utility

$$P_i(q, r) : \max_{(c_i, l_i, a_i)} \left[ U_i(c_i) := \sum_{\xi \in \mathcal{D}} u_{i,\xi}(c_{i,\xi}) \right]$$

subject to, for all  $\xi \geq \xi_0$ ,

$$l_{i,\xi} \geq 0 \tag{44}$$

$$c_{i,\xi} + q_\xi l_{i,\xi} + r_\xi a_{i,\xi} \leq e_{i,\xi} + q_\xi l_{i,\xi^-} + F_{i,\xi}(l_{i,\xi^-}) + a_{i,\xi^-} \tag{45}$$

$$a_{i,\xi} \geq -f_i [q_{\xi'} l_{i,\xi} + F_{i,\xi'}(l_{i,\xi})] \quad \forall \xi' \in \xi^+, \tag{46}$$

where  $l_{i,\xi_0^-} > 0$  is given and  $a_{i,\xi_0^-} = 0$ . Notice that we allow for non-stationary production functions.

The deterministic model corresponds to the case where  $\mathcal{D} = \{0, 1, 2, \dots\}$  and  $u_{i,\xi}(c) = \beta_i^{t(\xi)} u_i(c)$ . Another particular case of our model, where  $F_{i,\xi} = 0$ ,  $f_i = 0 \forall i, \forall \xi$ , and there is no short-sale, corresponds to [Pascoa et al. \(2011\)](#). In this case, land can be interpreted as fiat money. However, [Pascoa et al. \(2011\)](#) assume that agents have money endowments at each node while we consider that agents have land endowments only at initial node.

Since constraint (46) can be interpreted as a collateral constraint, our stochastic model is also related to [Gottardi and Kubler \(2015\)](#) where they construct a tractable model with collateral constraints and complete markets, and provide sufficient conditions for the existence of Markov equilibria. However, when financial markets are incomplete like in our model, as mentioned by [Gottardi and Kubler \(2015\)](#), it is not easy to find out robust equilibrium properties.

If we consider  $f_i = 1$ , constraint (46) corresponds to solvency constraint (4) in [Chien and Lustig \(2010\)](#) where they consider a model with a continuum of identical agents and a complete menu of contingent claims. In our model, there are a finite number of heterogeneous agents but financial markets are incomplete.

The economy is denoted by  $\mathcal{E}$  characterized by a list of fundamentals

$$\mathcal{E}_s := \left( (u_{i,\xi}, e_{i,\xi}, F_{i,\xi})_{\xi \in \mathcal{D}}, f_i, l_{i,\xi_0^-} \right)_{i \in I}.$$

**Definition 6.** Given the economy  $\mathcal{E}_s$ , a list  $(\bar{q}_\xi, \bar{r}_\xi, (\bar{c}_{i,\xi}, \bar{l}_{i,\xi}, \bar{a}_{i,\xi})_{i=1}^m)_{\xi \in \mathcal{D}}$  is an intertemporal equilibrium if the following conditions are satisfied:

(i) Price positivity:  $\bar{q}_\xi, \bar{r}_\xi > 0 \forall \xi$ .

(ii) Market clearing: for all  $\xi$ ,

$$\text{good: } \sum_{i=1}^m \bar{c}_{i,\xi} = \sum_{i=1}^m (e_{i,\xi} + F_{i,\xi}(\bar{l}_{i,\xi^-})) \quad (47)$$

$$\text{land: } \sum_{i=1}^m \bar{l}_{i,\xi} = L \quad (48)$$

$$\text{financial asset: } \sum_{i=1}^m \bar{a}_{i,\xi} = 0. \quad (49)$$

(iii) Agents' optimality: for all  $i$ ,  $(\bar{c}_{i,\xi}, \bar{l}_{i,\xi}, \bar{a}_{i,\xi})_{\xi \in \mathcal{D}}$  is a solution of the problem  $P_i(\bar{q}, \bar{r})$ .

Some standard assumptions are required in order to get the equilibrium existence.

**Assumption 6** (production functions). For all  $i$  and  $\xi$ , the function  $F_{i,\xi}$  is concave, continuously differentiable,  $F'_{i,\xi} > 0$ ,  $F_{i,\xi}(0) = 0$ .

**Assumption 7** (endowments).  $l_{i,\xi_0^-} > 0$  and  $a_{i,\xi_0^-} = 0 \forall i$ .  $e_{i,t} > 0 \forall i, \forall t$ .

**Assumption 8** (utility functions). For all  $i$  and  $\xi \in \mathcal{D}$ , the function  $u_{i,\xi} : \mathbb{R}_+ \rightarrow \mathbb{R}_+$  is continuously differentiable, concave,  $u_{i,\xi}(0) = 0$ ,  $u'_{i,\xi} > 0$ ,  $u'_{i,\xi}(0) = \infty$ .

**Assumption 9** (finite utility). For all  $i$ ,

$$\sum_{\xi \in \mathcal{D}} u_{i,\xi}(W_\xi) < \infty, \quad \text{where } W_\xi := \sum_{i=1}^m (e_{i,\xi} + F_{i,\xi}(L)). \quad (50)$$

Under assumptions 3, 6, 7, 8, 9, we can prove, by adapting the proof in Bosi et al. (2017b), that there exists an intertemporal equilibrium. We next provide basic equilibrium properties.

**Proposition 10.**

1. Let  $(q, r, (c_i, l_i, a_i)_i)$  be an equilibrium. There exists positive sequences of multipliers  $(\lambda_{i,\xi}, \eta_{i,\xi})_{\xi \in \mathcal{D}}$ ,  $(\mu_{i,\xi})_{\xi \in \mathcal{D}: t(\xi) \geq 1}$  such that

$$c_{i,\xi} : u'_{i,\xi}(c_{i,\xi}) = \lambda_{i,\xi} \quad (51)$$

$$a_{i,\xi} : r_\xi \lambda_{i,\xi} = \sum_{\xi' \in \xi^+} (\lambda_{i,\xi'} + \mu_{i,\xi'}) \quad (52)$$

$$l_{i,\xi} : \lambda_{i,\xi} q_\xi = \sum_{\xi' \in \xi^+} (\lambda_{i,\xi'} + f_i \mu_{i,\xi'}) (q_{\xi'} + F'_{i,\xi}(l_{i,\xi})) + \eta_{i,\xi} \quad (53)$$

$$\eta_{i,\xi} l_{i,\xi} = 0 \quad (54)$$

$$\mu_{i,\xi'} (a_{i,\xi} + f_i [q_{\xi'} l_{i,\xi} + F_{i,\xi'}(l_{i,\xi})]) = 0 \forall \xi' \in \xi^+ \quad (55)$$

$$\text{Transversality condition: } \lim_{T \rightarrow \infty} \sum_{\xi \in \mathcal{D}_T} \lambda_{i,\xi} (q_\xi l_{i,\xi} + r_\xi a_{i,\xi}) = 0 \quad (56)$$

2. If the sequences  $(q, r, (c_i, l_i, a_i)_i)$  and  $(\lambda_i, \eta_i, \mu_i)_i$  satisfy

- (a)  $c_{i,\xi}, l_{i,\xi}, \lambda_{i,\xi}, \eta_{i,\xi}, \mu_{i,\xi'} \geq 0$ ;  $q_\xi, r_\xi > 0 \forall \xi \in \mathcal{D}$  and  $\forall \xi' \in \xi^+$ .
- (b) conditions (45) is binding, and (44), (46), (47), (48), (49) hold;
- (c) conditions (51), (52), (53), (54), (55), (56) hold;
- (d)  $\sum_{\xi \in \mathcal{D}} u_{i,\xi}(c_{i,\xi}) < \infty \forall i$ ;

then  $(q, r, (c_i, l_i, a_i)_i)$  is an intertemporal equilibrium.

*Proof.* See Appendix E. □

## 6.2 Land valuation

### 6.2.1 Individual valuation and bubble

We give an extension of analysis in Section 4.2. For each  $\xi' \in \xi^+$ , let us denote  $P_{\xi\xi'}$  the probability that the successor of  $\xi$  is  $\xi'$ . We have  $\sum_{\xi' \in \xi^+} P_{\xi\xi'} = 1$ . According to (53), we have

$$\begin{aligned} q_\xi &= \sum_{\xi' \in \xi^+} \frac{\lambda_{i,\xi'} + f_i \mu_{i,\xi'}}{\lambda_{i,\xi}} (q_{\xi'} + F'_{i,\xi'}(l_{i,\xi})) + \frac{\eta_{i,\xi}}{\lambda_{i,\xi}} \\ &= \sum_{\xi' \in \xi^+} \frac{\lambda_{i,\xi'}}{\lambda_{i,\xi}} \left( \underbrace{q_{\xi'} + F'_{i,\xi'}(l_{i,\xi})}_{\text{Production return}} + \underbrace{\frac{P_{\xi\xi'} \eta_{i,\xi}}{\lambda_{i,\xi'}} + \frac{f_i \mu_{i,\xi'}}{\lambda_{i,\xi'}} (q_{\xi'} + F'_{i,\xi'}(l_{i,\xi}))}_{\text{Collateral return}} \right) \end{aligned} \quad (57)$$

Denote  $d_{i,\xi'} := F'_{i,\xi'}(l_{i,\xi}) + \frac{P_{\xi\xi'} \eta_{i,\xi}}{\lambda_{i,\xi'}} + \frac{f_i \mu_{i,\xi'}}{\lambda_{i,\xi'}} (q_{\xi'} + F'_{i,\xi'}(l_{i,\xi}))$  and  $\gamma_{i,\xi'} := \frac{\lambda_{i,\xi'}}{\lambda_{i,\xi}} \forall \xi' \in \xi^+$ . For each  $\xi$ , we denote  $Q_{i,\xi} := \prod_{\mu \leq \xi} \gamma_{i,\mu} = \frac{\lambda_{i,\xi}}{\lambda_{i,\xi_0}}$ . We have land price decomposition

$$\begin{aligned} q_{\xi_0} &= \sum_{\xi \in \xi_0^+} \gamma_{i,\xi} (q_\xi + d_{i,\xi}) = \sum_{\xi \in \xi_0^+} Q_{i,\xi} d_{i,\xi} + \sum_{\xi \in \xi_0^+} \gamma_{i,\xi} q_\xi \\ &= \sum_{t=1}^T \sum_{\xi \in D_t} Q_{i,\xi} d_{i,\xi} + \sum_{\xi \in D_T} Q_{i,\xi} q_\xi \end{aligned} \quad (58)$$

**Definition 7** (individual bubble).  $FV_i := \sum_{t=1}^{\infty} \sum_{\xi \in D_t} Q_{i,\xi} d_{i,\xi}$  is the  $i$ -fundamental value of land.

We say that a  $i$ -land bubble exists if  $q_{\xi_0} > FV_i$ .

This can be viewed as a generalized version of fiat money valuation in Pascoa et al. (2011) which corresponds to the case where  $F_{i,\xi} = 0$  and short-sales are not allowed i.e.,  $f_i = 0$ .

The following result shows the role of heterogeneity of agents.

**Proposition 11.** 1. If there is  $M > 0$  such that  $\lambda_{i,\xi} / \lambda_{j,\xi} < M \forall i, \forall j, \forall \xi$ , then  $q_0 = FV_i \forall i$ .

2. If there exists  $t_0$  such that  $\gamma_{i,\xi} = \gamma_{j,\xi} \forall i, \forall j, \forall \xi$  with  $t(\xi) \geq t_0$ , then  $q_0 = FV_i \forall i$ .

*Proof.* Since point 2 is a direct consequence of point 1, let us prove point 1. Given  $i$ . We have  $\lambda_{i,\xi} (q_\xi l_{j,\xi} + r_\xi a_{j,\xi}) \leq M \lambda_{j,\xi} (q_\xi l_{j,\xi} + r_\xi a_{j,\xi})$ , so

$$\lim_{T \rightarrow \infty} \sum_{\xi \in D_T} \lambda_{i,\xi} (q_\xi l_{j,\xi} + r_\xi a_{j,\xi}) = 0 \quad (59)$$

for any  $j$ . Taking the sum over  $j$ , we have  $\lim_{T \rightarrow \infty} \sum_{\xi \in D_T} \lambda_{i,\xi} q_\xi L = 0$  which implies that  $q_0 = FV_i$ . □



### 6.2.2 In search of a theory of valuation

Given a node  $\xi$ , since  $\sum_i l_{i,\xi} = L > 0$ , there exists  $i = i(\xi)$  such that  $l_{i,\xi} > 0$ . By combining this with condition (53) in Proposition 10, we have

$$q_\xi = \sum_{\xi' \in \xi^+} \frac{\lambda_{i,\xi'} + f_i \mu_{i,\xi'}}{\lambda_{i,\xi}} \left( q_{\xi'} + F'_{i,\xi'}(l_{i,\xi}) \right). \quad (60)$$

**Corollary 7.** *Consider a particular case (the Lucas tree):  $F_{i,\xi}(x) = d_\xi x \forall i, \forall \xi$ . For each  $\xi$ , there is a state-price process  $(\gamma_{\xi'})_{\xi' \in \xi^+}$  such that*

$$q_\xi = \sum_{\xi' \in \xi^+} \gamma_{\xi'} \left( q_{\xi'} + d_{\xi'} \right) \quad (61)$$

Equation (61) is the traditional intertemporal no-arbitrage. According to this result, we can apply the approach of Santos and Woodford (1997). In the deterministic case, we have proved that there is a unique state-price process  $(\gamma_t)$  given by  $\gamma_t = r_{t-1} \forall t \geq 0$ . However, in the stochastic case with incomplete markets, the uniqueness of  $(\gamma_\xi)$  is not ensured. Indeed, for each  $i$ ,  $\left( \frac{\lambda_{i,\xi'} + f_i \mu_{i,\xi'}}{\lambda_{i,\xi}} \right)_{\xi' \in \xi^+}$  is a state-prices process.

In the standard case where assets have exogenous dividends, it is sufficient to define state-price process in order to evaluate assets as in Santos and Woodford (1997), Montrucchio (2004). In our model, not only state-prices process but also dividends need to be defined. So, what is the dividend of land? It is value added that land brings for the economy. Since land can be used by any agent, dividend of land at note  $\xi' \in \xi^+$  should be greater than  $\min_i F'_{i,\xi'}(l_{i,\xi})$ . This idea leads to the following concept.

**Definition 8.** *Consider an equilibrium and fix a node  $\xi$ .  $\Gamma_\xi := (\gamma_{\xi'}, d_{\xi'})_{\xi' \in \xi^+}$  is called a state-price (or discount factor) and land dividend process if*

$$d_{\xi'} \geq \min_i F'_{i,\xi'}(l_{i,\xi}) \quad \forall \xi' \in \xi^+ \quad (62)$$

$$q_\xi = \sum_{\xi' \in \xi^+} \gamma_{\xi'} \left( q_{\xi'} + d_{\xi'} \right) \quad (63)$$

According to (57) or (60), the set of all state-price and land dividend process is not empty. Definition 8 covers the traditional intertemporal pricing of assets with exogenous dividends (Santos and Woodford, 1997; Montrucchio, 2004). It also covers the concepts of (individual) dividends of land in our deterministic case and in Section 6.2.1 for the stochastic case. Moreover, we propose an approach for valuation of productive assets which are more general than the fiat money in Pascoa et al. (2011).

Miao and Wang (2012, 2015) also consider valuation of stocks with endogenous dividends. However, their approach cannot be applied for valuation of land in our model because land can be used by many agents while a stock in Miao and Wang (2012, 2015) is issued by only one firm and stock dividends are taken as given by other agents.

Given a process of state-price and land dividend  $\Gamma := (\gamma_\xi, d_\xi)_{\xi \in \mathcal{D}}$ , let us denote  $Q_\xi := \prod_{\xi' \leq \xi} \gamma_{\xi'}$ . Hence, we can provide

$$q_{\xi_0} = \sum_{t=1}^T \sum_{\xi \in D_t} Q_\xi d_\xi + \sum_{\xi \in D_T} Q_\xi q_\xi \quad (64)$$

**Definition 9.** Given a process of state-price and land dividend  $\Gamma := (\gamma_\xi, d_\xi)_{\xi \in \mathcal{D}}$ , the fundamental value of land associated to this process is defined by  $FV_\Gamma := \sum_{t=1}^{\infty} \sum_{\xi \in D_t} Q_\xi d_\xi$ . We say that a  $\Gamma$ -land bubble exists if  $q_{\xi_0} > FV_\Gamma$ .

One may ask whether we can choose  $d_\xi = 0 \forall \xi$ , which implies the fundamental value of land equals zero, and then say that bubbles always exist. This cannot be done because condition (62) in Definition 8 must be respected.

Before providing results on land-price bubbles, we present the assumption of uniform impatience mentioned in Levine and Zame (1996), Magill and Quinzii (1994), Santos and Woodford (1997), Pascoa et al. (2011).

Given a consumption plan  $c = (c_\mu)_{\mu \in \mathcal{D}}$ , a node  $\xi$ , a vector  $(\gamma, \delta) \in (0, 1) \times \mathbb{R}_+$ , we define another consumption plan, called  $z = z(c, \xi, \gamma, \delta)$ , by

$$z_\mu = c_\mu \quad \forall \mu \in \mathcal{D} \setminus D(\xi) \quad (65)$$

$$z_\xi = c_\xi + \delta \quad (66)$$

$$z_\mu = \gamma c_\mu \quad \forall \mu > \xi. \quad (67)$$

**Assumption 10** (Uniform impatience). *There exists  $\gamma \in (0, 1)$  such that for all consumption plan  $c = (c_\mu)$  with  $0 \leq c_\mu \leq W_\mu \forall \mu \in \mathcal{D}$ , we have*

$$U_i(z(c, \xi, \gamma', W_\xi)) > U_i(c) \quad \forall i, \forall \xi \in \mathcal{D}, \forall \gamma' \in [\gamma, 1). \quad (68)$$

One can prove, by using the same argument in Proposition 1 in Pascoa et al. (2011), that when  $(W_\xi)_{\xi \in \mathcal{D}}$  is bounded, the standard utility function  $U_i(c) = \sum_\xi \beta_i^{t(\xi)} P_{i,\xi} u_i(c_\xi)$ , where  $\beta_i \in (0, 1)$  and  $P_{i,\xi}$  (the probability to reach node  $\xi$ ) is strictly positive, satisfies Assumption 10.

The main contribution of this section is to provide conditions under which bubbles are ruled out.

**Proposition 12.** *Let Assumption 10 be satisfied and consider an equilibrium  $(q, r, (c_i, l_i, a_i)_i)$ .*

1. (Endogenous condition.) *For any  $\Gamma$  such that  $\lim_{t \rightarrow \infty} \sum_{\xi \in D_t} Q_\xi W_\xi = 0$ , we have  $q_{\xi_0} = FV_\Gamma$ .*
2. (Exogenous condition.) *Assume that  $\sup_\xi W_\xi < \infty$ . Assume also that  $\inf_{i,\xi} F'_{i,\xi}(L) > 0$ . For any process of state-price and land dividend, there is no land asset bubble, i.e.,  $q_{\xi_0} = FV_\Gamma \forall \Gamma$ .*

*Proof.* See Appendix E. □

Let us explain the intuition of point 1 of Proposition Proposition 12. Thanks to uniform impatience, the ratio of savings to wealth is uniformly bounded. When the discounted value of aggregate wealth is vanishing at infinity, the discounted value of aggregate land quantity at infinity must be zero, i.e., bubbles are ruled out.

Some comments should be mentioned.

- Point 1 of Proposition 12 is related to Theorem 3.3 in Santos and Woodford (1997). The common point is that the uniform impatience is required. However, there are two main differences: (1) we deal with land (which has endogenous dividends because anyone can use land to produce) while Santos and Woodford (1997) work with exogenous dividends, and (ii) we only need  $\lim_{t \rightarrow \infty} \sum_{\xi \in D_t} Q_\xi W_\xi = 0$  while Santos and Woodford (1997) require  $\sum_{t \geq 1} \sum_{\xi \in D_t} Q_\xi W_\xi < \infty$ .

- Point 2 of Proposition 12 complements Proposition 7 in the current paper. Proposition 12 needs the uniform impatience but borrowing limits ( $f_i$ ) can be arbitrary in  $[0, 1]$  while Proposition 7 does not need the uniform impatience but there is no uncertainty and the financial system must be good enough in the sense that  $f_i = 1 \forall i$ .
- Corollary 1 in Pascoa et al. (2011) indicates that there exists a plan of non-arbitrage deflators for which fiat money has a bubble. However, under conditions of point 2 of Proposition 12, there is no land bubble for any process of state-prices and dividends. So, the insight in Corollary 1 in Pascoa et al. (2011) may not hold when we work with productive assets such as land in our model.

## 7 Conclusion

We have built dynamic general equilibrium models with heterogeneous agents and incomplete financial markets, which cover a large class of models used in macroeconomics. First-order and transversality conditions have been proved. Contrary to standard capital accumulation models à la Ramsey, in our model the most patient may not hold the entire stock of land in the long run.

Our paper has provided an approach to the valuation of land. In a bounded economy with stationary production functions and uniform impatience, for any process of state-prices and dividends the price of land equals its fundamental value associated to this process; this holds whatever the level of borrowing limit and of market incompleteness. A number of examples of (individual) bubbles are provided in economies with and without short-sales. Our approach can be used to evaluate other kinds of asset or input such as house or physical capital.

## Appendices

### A Proofs for Section 2.1

**Proof of part 1 of Proposition 1.** Let us prove the transversality condition.<sup>14</sup> Notice that our method here is different from Araujo et al. (2011). Denote  $x_i := (l_i, a_i) = (l_{i,t}, a_{i,t})_t$ . We say that  $x_i$  is feasible if, for all  $t$ , we have  $l_{i,t} \geq 0$  and

$$\begin{aligned} a_{i,t} &\geq -f_i(q_{t+1}l_{i,t} + F_i(l_{i,t})) \\ q_t l_{i,t} + r_t a_{i,t} &\leq e_{i,t} + q_t l_{i,t-1} + F_i(l_{i,t-1}) + a_{i,t-1}. \end{aligned}$$

We claim that: if  $x_i$  is feasible, then  $(x_{i,0}, \dots, x_{i,t-1}, \lambda x_{i,t}, \lambda x_{i,t+1}, \dots)$  is also feasible for all  $t \geq 1$  and  $\lambda \in [0, 1]$ .

We have to prove that:

$$q_t \lambda l_{i,t} + \lambda r_t a_{i,t} \leq e_{i,t} + q_t l_{i,t-1} + F_i(l_{i,t-1}) + a_{i,t-1} \quad (\text{A.1})$$

and

$$\lambda q_{s+1} l_{i,s+1} + \lambda r_{s+1} a_{i,s+1} \leq e_{i,s+1} + \lambda q_{s+1} l_{i,s} + F_i(\lambda l_{i,s}) + \lambda a_{i,s} \quad (\text{A.2})$$

$$\lambda a_{i,s} + f_i(\lambda q_{s+1} l_{i,s} + F_i(\lambda l_{i,s})) \geq 0 \quad (\text{A.3})$$

for all  $s \geq t$ .

<sup>14</sup>FOCs are obtained by applying the proof of Proposition 10 in Appendix E.

(A.2) and (A.3) are proved by using the fact that  $F_i(\lambda x) \geq \lambda F_i(x) \forall \lambda \in [0, 1]$ .  
(A.1) is satisfied if  $q_t l_{i,t} + r_t a_{i,t} < 0$ . If  $q_t l_{i,t} + r_t a_{i,t} \geq 0$ , we have

$$q_t \lambda l_{i,t} + \lambda r_t a_{i,t} \leq q_t l_{i,t} + r_t a_{i,t} \leq e_{i,t} + q_t l_{i,t-1} + F_i(l_{i,t-1}) + a_{i,t-1}.$$

So, our claim is proved.

By using the same argument in Theorem 2.1 in Kamihigashi (2002),<sup>15</sup> we obtain that  $\limsup_{t \rightarrow \infty} \lambda_{i,t}(q_t l_{i,t} + r_t a_{i,t}) \leq 0$ .

According to FOCs, we now have

$$\lambda_{i,t}(c_{i,t} + q_t l_{i,t} + r_t a_{i,t}) = \lambda_{i,t}(e_{i,t} + q_t l_{i,t-1} + F_i(l_{i,t-1}) + a_{i,t-1}) \quad (\text{A.4})$$

$$\lambda_{i,t} r_t a_{i,t} = (\lambda_{i,t+1} + \mu_{i,t+1}) a_{i,t} \quad (\text{A.5})$$

$$\lambda_{i,t} q_t l_{i,t} = (\lambda_{i,t+1} + f_i \mu_{i,t+1})(q_{t+1} + F'_i(l_{i,t})) l_{i,t} \quad (\text{A.6})$$

$$\mu_{i,t+1} \left( a_{i,t} + f_i(q_{t+1} l_{i,t} + F_i(l_{i,t})) \right) = 0. \quad (\text{A.7})$$

(A.5) and (A.6) imply that

$$\begin{aligned} & \lambda_{i,t}(q_t l_{i,t} + r_t a_{i,t}) \\ &= (\lambda_{i,t+1} + f_i \mu_{i,t+1})(q_{t+1} + F'_i(l_{i,t})) l_{i,t} + (\lambda_{i,t+1} + \mu_{i,t+1}) a_{i,t} \\ &= \lambda_{i,t+1} a_{i,t} + \lambda_{i,t+1} (q_{t+1} + F'_i(l_{i,t})) l_{i,t} \\ &+ \mu_{i,t+1} \left( a_{i,t} + f_i(q_{t+1} + F'_i(l_{i,t})) l_{i,t} \right). \end{aligned}$$

Therefore, by combining this with (A.7), we get that

$$\begin{aligned} & \lambda_{i,t}(q_t l_{i,t} + r_t a_{i,t}) - \lambda_{i,t+1} a_{i,t} - \lambda_{i,t+1} (q_{t+1} l_{i,t} + F_i(l_{i,t})) \\ &= \lambda_{i,t+1} (q_{t+1} + F'_i(l_{i,t})) l_{i,t} + \mu_{i,t+1} \left( a_{i,t} + f_i(q_{t+1} + F'_i(l_{i,t})) l_{i,t} \right) \\ &- \lambda_{i,t+1} (q_{t+1} l_{i,t} + F_i(l_{i,t})) \quad (\text{A.8}) \end{aligned}$$

$$\begin{aligned} &= -\lambda_{i,t+1} (F_i(l_{i,t}) - l_{i,t} F'_i(l_{i,t})) + \mu_{i,t+1} \left( a_{i,t} + f_i(q_{t+1} + F'_i(l_{i,t})) l_{i,t} \right) \\ &- \mu_{i,t+1} \left( a_{i,t} + f_i(q_{t+1} l_{i,t} + F_i(l_{i,t})) \right) \quad (\text{A.9}) \end{aligned}$$

$$= -\lambda_{i,t+1} (F_i(l_{i,t}) - l_{i,t} F'_i(l_{i,t})) - f_i \mu_{i,t+1} (F_i(l_{i,t}) - l_{i,t} F'_i(l_{i,t})) \quad (\text{A.10})$$

By summing (A.4) from  $t = 0$  to  $T$ , and then using (A.8), we obtain that

$$\begin{aligned} \sum_{t=0}^T \lambda_{i,t} c_{i,t} + \lambda_{i,T} (q_T l_{i,T} + r_T a_{i,T}) &= \sum_{t=0}^T \lambda_{i,t} e_{i,t} + \lambda_{i,0} (q_0 l_{i,-1} + F_i(l_{i,-1}) + a_{i,-1}) \\ &+ \sum_{t=1}^T (\lambda_{i,t} + f_i \mu_{i,t}) (F_i(l_{i,t-1}) - l_{i,t-1} F'_i(l_{i,t-1})). \quad (\text{A.11}) \end{aligned}$$

Under Assumption (5), the utility of agent  $i$  is finite, thus we have

$$\sum_{t=0}^{\infty} \lambda_{i,t} c_{i,t} = \sum_{t=0}^{\infty} \beta_i^t u'_i(c_{i,t}) c_{i,t} \leq \sum_{t=0}^{\infty} \beta_i^t u_i(c_{i,t}) < \infty. \quad (\text{A.12})$$

Combining this with the fact that  $\limsup_{t \rightarrow \infty} \lambda_{i,t}(q_t l_{i,t} + r_t a_{i,t}) \leq 0$ , and (A.11), we obtain that there exists the following sum

$$\sum_{t=0}^{\infty} \lambda_{i,t} e_{i,t} + \sum_{t=1}^{\infty} (\lambda_{i,t} + f_i \mu_{i,t}) (F_i(l_{i,t-1}) - l_{i,t-1} F'_i(l_{i,t-1})) < \infty.$$

<sup>15</sup>Kamihigashi (2002) only considers positive allocations while  $a_{i,t}$  may be negative in our model.

We now use (A.11) to get that  $\lim_{t \rightarrow \infty} \lambda_{i,t}(q_t l_{i,t} + r_t a_{i,t})$  exists and it is non positive.

We again use (A.4) and note that  $q_t l_{i,t-1} + F_i(l_{i,t-1}) + a_{i,t-1} \geq 0$  (because of borrowing constraint) to obtain that  $\liminf_{t \rightarrow \infty} \lambda_{i,t}(c_{i,t} + q_t l_{i,t} + r_t a_{i,t}) \geq 0$ .

(A.12) implies that  $\lim_{t \rightarrow \infty} \lambda_{i,t} c_{i,t} = 0$ . As a result, we get  $\liminf_{t \rightarrow \infty} \lambda_{i,t}(q_t l_{i,t} + r_t a_{i,t}) \geq 0$ . Therefore, we have  $\lim_{t \rightarrow \infty} \lambda_{i,t}(q_t l_{i,t} + r_t a_{i,t}) = 0$  and then

$$\begin{aligned} \infty > \sum_{t=0}^{\infty} \lambda_{i,t} c_{i,t} &= \sum_{t=0}^{\infty} \lambda_{i,t} e_{i,t} + \sum_{t=1}^{\infty} (\lambda_{i,t} + f_i \mu_{i,t})(F_i(l_{i,t-1}) - l_{i,t-1} F'_i(l_{i,t-1})) \\ &\quad + \lambda_{i,0}(q_0 l_{i,-1} + F_i(l_{i,-1}) + a_{i,-1}). \end{aligned} \quad (\text{A.13})$$

□

**Proof of part 2 of Proposition 1.** Before proving this part, we should notice that this result requires neither  $u_i(0) = 0$  nor  $u'_i(0) = \infty$ . Let us prove our result. It is sufficient to prove the optimality of  $(c_i, a_i, l_i)$  for all  $i$ . Let  $(c'_i, a'_i, l'_i)$  be a plan satisfying all budget and borrowing constraints and  $l'_{i,-1} - l_{i,-1} = 0 = a'_{i,-1} = a_{i,-1}$ . We have

$$\sum_{t=0}^T \beta_i^t (u_i(c_{i,t}) - u_i(c'_{i,t})) \geq \sum_{t=0}^T \beta_i^t u'_i(c_{i,t})(c_{i,t} - c'_{i,t}) = \sum_{t=0}^T \lambda_{i,t}(c_{i,t} - c'_{i,t})$$

According to FOCs, we now have

$$\lambda_{i,t}(c'_{i,t} + q_t l'_{i,t} + r_t a'_{i,t}) = \lambda_{i,t}(e_{i,t} + q_t l'_{i,t-1} + F_i(l'_{i,t-1}) + a'_{i,t-1}) \quad (\text{A.14})$$

$$r_t \lambda_{i,t} a'_{i,t} = (\lambda_{i,t+1} + \mu_{i,t+1}) a'_{i,t} \quad (\text{A.15})$$

$$\lambda_{i,t} q_t l'_{i,t} = (\lambda_{i,t+1} + f_i \mu_{i,t+1})(q_{t+1} + F'_i(l_{i,t})) l'_{i,t} + \eta_{i,t} l'_{i,t} \quad (\text{A.16})$$

$$\mu_{i,t+1} (a_{i,t} + f_i(q_{t+1} l_{i,t} + F_i(l_{i,t}))) = 0. \quad (\text{A.17})$$

(A.15) and (A.16) imply that

$$\begin{aligned} &\lambda_{i,t}(q_t l'_{i,t} + r_t a'_{i,t}) \\ &= (\lambda_{i,t+1} + f_i \mu_{i,t+1})(q_{t+1} + F'_i(l_{i,t})) l'_{i,t} + \eta_{i,t} l'_{i,t} + (\lambda_{i,t+1} + \mu_{i,t+1}) a'_{i,t} \\ &= \lambda_{i,t+1} a'_{i,t} + \lambda_{i,t+1} (q_{t+1} + F'_i(l_{i,t})) l'_{i,t} + \eta_{i,t} l'_{i,t} + \mu_{i,t+1} (a'_{i,t} + f_i(q_{t+1} + F'_i(l_{i,t})) l'_{i,t}). \end{aligned}$$

Therefore, by combining this with (A.17), we get that

$$\begin{aligned} &\lambda_{i,t}(q_t l'_{i,t} + r_t a'_{i,t}) - \lambda_{i,t+1} a'_{i,t} - \lambda_{i,t+1} (q_{t+1} l'_{i,t} + F_i(l'_{i,t})) \\ &= \lambda_{i,t+1} (q_{t+1} + F'_i(l_{i,t})) l'_{i,t} + \eta_{i,t} l'_{i,t} + \mu_{i,t+1} (a'_{i,t} + f_i(q_{t+1} + F'_i(l_{i,t})) l'_{i,t}) \\ &\quad - \lambda_{i,t+1} (q_{t+1} l'_{i,t} + F_i(l'_{i,t})) \\ &= -\lambda_{i,t+1} (F_i(l'_{i,t}) - l'_{i,t} F'_i(l_{i,t})) + \eta_{i,t} l'_{i,t} + \mu_{i,t+1} (a'_{i,t} + f_i(q_{t+1} + F'_i(l_{i,t})) l'_{i,t}). \end{aligned} \quad (\text{A.18})$$

According to budget constraints, we have

$$\begin{aligned} &\lambda_{i,t+1}(e_{i,t+1} - c'_{i,t+1}) + \lambda_{i,t}(q_t l'_{i,t} + r_t a'_{i,t}) - \lambda_{i,t+1}(q_{t+1} l'_{i,t+1} + r_{t+1} a'_{i,t+1}) \\ &= \lambda_{i,t}(q_t l'_{i,t} + r_t a'_{i,t}) - \lambda_{i,t+1} a'_{i,t} - \lambda_{i,t+1}(q_{t+1} l'_{i,t} + F_i(l'_{i,t})) \end{aligned} \quad (\text{A.19})$$

$$\lambda_{i,0} p_0 (e_{i,0} - c'_{i,0}) - \lambda_{i,0} (q_0 l'_{i,0} + r_0 a'_{i,0}) + \lambda_{i,0} (q_0 l'_{i,-1} + F_i(l'_{i,-1})) = 0. \quad (\text{A.20})$$

By summing these constraints and using (A.18), we obtain that

$$\begin{aligned} & \left[ \sum_{t=0}^T \lambda_{i,t}(e_{i,t} - c'_{i,t}) \right] - \lambda_{i,T}(q_T l'_{i,T} + r_T a'_{i,T}) + \lambda_{i,0}(q_0 l'_{i,-1} + F_i(l'_{i,-1})) \\ &= \sum_{t=1}^T \left[ -\lambda_{i,t}(F_i(l'_{i,t-1}) - l'_{i,t-1} F'_i(l_{i,t-1})) + \eta_{i,t-1} l'_{i,t-1} + \mu_{i,t}(a'_{i,t-1} + f_i(q_t + F'_i(l_{i,t-1})) l'_{i,t-1}) \right] \end{aligned}$$

Since this is satisfied for any feasible allocation  $(c'_i, a'_i, l'_i)$ , this also holds for the allocation  $(c_i, a_i, l_i)$ . Consequently, we get that

$$\begin{aligned} & \left[ \sum_{t=0}^T \lambda_{i,t}(c_{i,t} - c'_{i,t}) \right] \\ &= \lambda_{i,T}(q_T l'_{i,T} + r_T a'_{i,T}) - \lambda_{i,T}(q_T l_{i,T} + r_T a_{i,T}) \\ & \quad + \sum_{t=1}^T \left[ -\lambda_{i,t}(F_i(l'_{i,t-1}) - l'_{i,t-1} F'_i(l_{i,t-1})) + \eta_{i,t-1} l'_{i,t-1} + \mu_{i,t}(a'_{i,t-1} + f_i(q_t + F'_i(l_{i,t-1})) l'_{i,t-1}) \right] \\ & \quad - \sum_{t=1}^T \left[ -\lambda_{i,t}(F_i(l_{i,t-1}) - l_{i,t-1} F'_i(l_{i,t-1})) + \eta_{i,t-1} l_{i,t-1} + \mu_{i,t}(a_{i,t-1} + f_i(q_t + F'_i(l_{i,t-1})) l_{i,t-1}) \right] \\ &= \lambda_{i,T}(q_T l'_{i,T} + r_T a'_{i,T}) - \lambda_{i,T}(q_T l_{i,T} + r_T a_{i,T}) + \sum_{t=1}^T \eta_{i,t-1}(l'_{i,t-1} - l_{i,t-1}) \\ & \quad + \sum_{t=1}^T \lambda_{i,t} \left[ F_i(l_{i,t-1}) - F_i(l'_{i,t-1}) - (l_{i,t-1} - l'_{i,t-1}) F'_i(l_{i,t-1}) \right] \\ & \quad + \sum_{t=1}^T \mu_{i,t} \left( a'_{i,t-1} + f_i(q_t l'_{i,t-1} + F'_i(l_{i,t-1}) l'_{i,t-1}) - (a_{i,t-1} + f_i(q_t l_{i,t-1} + F'_i(l_{i,t-1}) l_{i,t-1})) \right) \\ &= \lambda_{i,T}(q_T l'_{i,T} + r_T a'_{i,T}) - \lambda_{i,T}(q_T l_{i,T} + r_T a_{i,T}) + \sum_{t=1}^T \eta_{i,t-1}(l'_{i,t-1} - l_{i,t-1}) \\ & \quad + \sum_{t=1}^T \lambda_{i,t} \left[ F_i(l_{i,t-1}) - F_i(l'_{i,t-1}) - (l_{i,t-1} - l'_{i,t-1}) F'_i(l_{i,t-1}) \right] \\ & \quad + \sum_{t=1}^T f_i \mu_{i,t} \left[ F_i(l_{i,t-1}) - F_i(l'_{i,t-1}) - (l_{i,t-1} - l'_{i,t-1}) F'_i(l_{i,t-1}) \right] \\ & \quad + \sum_{t=1}^T \mu_{i,t} \left( a'_{i,t-1} + f_i(q_t l'_{i,t-1} + F'_i(l'_{i,t-1})) - [a_{i,t-1} + f_i(q_t l_{i,t-1} + F'_i(l_{i,t-1}))] \right). \end{aligned}$$

Since  $F_i$  is concave, it is easy to see that  $F_i(l_{i,t}) - F_i(l'_{i,t}) \geq (l_{i,t} - l'_{i,t}) F'_i(l_{i,t}) \forall t$ . Thus, we obtain

$$\sum_{t=0}^T \beta_i^t (u_i(c_{i,t}) - u_i(c'_{i,t})) \geq \sum_{t=0}^T \lambda_{i,t}(c_{i,t} - c'_{i,t}) \geq \lambda_{i,T}(q_T l'_{i,T} + r_T a'_{i,T}) - \lambda_{i,T}(q_T l_{i,T} + r_T a_{i,T}).$$

We will prove that  $\liminf_{T \rightarrow \infty} \lambda_{i,T}(q_T l'_{i,T} + r_T a'_{i,T}) - \lambda_{i,T}(q_T l_{i,T} + r_T a_{i,T}) \geq 0$ . Combining this condition and the fact that  $\sum_{t=0}^{\infty} \beta_i^t u_i(c_{i,t}) < \infty$ , we conclude the optimality of  $(c_i, a_i, l_i)$ .

According to (A.15) and (A.16), we have

$$\begin{aligned}
& \lambda_{i,t}(q_t l'_{i,t} + r_t a'_{i,t}) \\
&= \lambda_{i,t+1} a'_{i,t} + \lambda_{i,t+1}(q_{t+1} + F'_i(l_{i,t})) l'_{i,t} + \eta_{i,t} l'_{i,t} + \mu_{i,t+1} (a'_{i,t} + f_i(q_{t+1} + F'_i(l_{i,t})) l'_{i,t}) \\
&= (\lambda_{i,t+1} + \mu_{i,t+1}) a'_{i,t} + \lambda_{i,t+1}(q_{t+1} + F'_i(l_{i,t})) l'_{i,t} + \eta_{i,t} l'_{i,t} + \mu_{i,t+1} f_i(q_{t+1} + F'_i(l_{i,t})) l'_{i,t} \\
&= (\lambda_{i,t+1} + \mu_{i,t+1}) (a'_{i,t} + f_i(q_{t+1} l'_{i,t} + F_i(l'_{i,t}))) - (\lambda_{i,t+1} + \mu_{i,t+1}) f_i(q_{t+1} l'_{i,t} + F_i(l'_{i,t})) \\
&\quad + \lambda_{i,t+1}(q_{t+1} + F'_i(l_{i,t})) l'_{i,t} + \eta_{i,t} l'_{i,t} + \mu_{i,t+1} f_i(q_{t+1} l'_{i,t} + F_i(l_{i,t}) l'_{i,t}) \\
&= (\lambda_{i,t+1} + \mu_{i,t+1}) (a'_{i,t} + f_i(q_{t+1} l'_{i,t} + F_i(l'_{i,t}))) + \eta_{i,t} l'_{i,t} - f_i(\lambda_{i,t+1} + \mu_{i,t+1}) F_i(l'_{i,t}) \\
&\quad - f_i(\lambda_{i,t+1} + \mu_{i,t+1}) q_{t+1} l'_{i,t} + \lambda_{i,t+1}(q_{t+1} + F'_i(l_{i,t})) l'_{i,t} + \mu_{i,t+1} f_i(q_{t+1} + F'_i(l_{i,t})) l'_{i,t} \\
&= (\lambda_{i,t+1} + \mu_{i,t+1}) (a'_{i,t} + f_i(q_{t+1} l'_{i,t} + F_i(l'_{i,t}))) + \eta_{i,t} l'_{i,t} - f_i(\lambda_{i,t+1} + \mu_{i,t+1}) (F_i(l'_{i,t}) - l'_{i,t} F'_i(l_{i,t})) \\
&\quad - (\lambda_{i,t+1} + \mu_{i,t+1}) f_i F'_i(l_{i,t}) l'_{i,t} - f_i(\lambda_{i,t+1} + \mu_{i,t+1}) q_{t+1} l'_{i,t} \\
&\quad + \lambda_{i,t+1}(q_{t+1} + F'_i(l_{i,t})) l'_{i,t} + \mu_{i,t+1} f_i(q_{t+1} + F'_i(l_{i,t})) l'_{i,t} \\
&= (\lambda_{i,t+1} + \mu_{i,t+1}) (a'_{i,t} + f_i(q_{t+1} l'_{i,t} + F_i(l'_{i,t}))) + \eta_{i,t} l'_{i,t} - f_i(\lambda_{i,t+1} + \mu_{i,t+1}) (F_i(l'_{i,t}) - l'_{i,t} F'_i(l_{i,t})) \\
&\quad + (1 - f_i) \lambda_{i,t+1} (q_{t+1} + F'_i(l_{i,t})) l'_{i,t}.
\end{aligned}$$

Since this is satisfied for any feasible allocation  $(c'_i, a'_i, l'_i)$ , this also holds for the allocation  $(c_i, a_i, l_i)$ . Hence, we get, by combining with FOCs of  $(c_i, a_i, l_i)$  and borrowing constraint associated to allocation  $(c'_i, a'_i, l'_i)$ , that

$$\begin{aligned}
& \lambda_{i,t}(q_t l'_{i,t} + r_t a'_{i,t}) - \lambda_{i,t}(q_t l_{i,t} + r_t a_{i,t}) \\
&= (\lambda_{i,t+1} + \mu_{i,t+1}) (a'_{i,t} + f_i(q_{t+1} l'_{i,t} + F_i(l'_{i,t}))) - (\lambda_{i,t+1} + \mu_{i,t+1}) (a_{i,t} + f_i(q_{t+1} l_{i,t} + F_i(l_{i,t}))) \\
&\quad + \eta_{i,t} l'_{i,t} - \eta_{i,t} l_{i,t} + f_i(\lambda_{i,t+1} + \mu_{i,t+1}) (F_i(l_{i,t}) - F_i(l'_{i,t}) - (l_{i,t} - l'_{i,t}) F'_i(l_{i,t})) \\
&\quad + (1 - f_i) \lambda_{i,t+1} (q_{t+1} + F'_i(l_{i,t})) l'_{i,t} - (1 - f_i) \lambda_{i,t+1} (q_{t+1} + F'_i(l_{i,t})) l_{i,t} \\
&\geq - \lambda_{i,t+1} (a_{i,t} + f_i(q_{t+1} l_{i,t} + F_i(l_{i,t}))) - (1 - f_i) \lambda_{i,t+1} (q_{t+1} + F'_i(l_{i,t})) l_{i,t}
\end{aligned}$$

As in proof of part 1 of Proposition 1, we notice that

$$\lim_{t \rightarrow \infty} \lambda_{i,t} c_{i,t} = \lim_{t \rightarrow \infty} \lambda_{i,t} e_{i,t} = \lim_{t \rightarrow \infty} \lambda_{i,t} (q_t l_{i,t} + r_t a_{i,t}) = 0.$$

Combining this with budget constraint, we get that  $\lim_{t \rightarrow \infty} \lambda_{i,t} (q_{i,t} l_{i,t-1} + F_i(l_{i,t-1}) + a_{i,t-1}) = 0$ . Therefore  $\lim_{t \rightarrow \infty} \lambda_{i,t} (f_i(q_{i,t} l_{i,t-1} + F_i(l_{i,t-1})) + a_{i,t-1}) = 0$ . Moreover, by borrowing constraint and concavity of  $F_i$ , we have

$$q_{i,t} l_{i,t-1} + F_i(l_{i,t-1}) + a_{i,t-1} \geq (1 - f_i)(q_{i,t} l_{i,t-1} + F_i(l_{i,t-1})) \geq (1 - f_i)(q_{i,t} + F'_i(l_{i,t-1})) l_{i,t-1}$$

which implies that  $\lim_{t \rightarrow \infty} (1 - f_i) \lambda_{i,t} (q_{i,t} + F'_i(l_{i,t-1})) l_{i,t-1} = 0$ . Therefore, we obtain that

$$\liminf_{T \rightarrow \infty} \lambda_{i,T} (q_T l'_{i,T} + r_T a'_{i,T}) - \lambda_{i,T} (q_T l_{i,T} + r_T a_{i,T}) \geq 0.$$

□

**Proof of Corollary 1.** Assume that there exists  $\lim_{t \rightarrow \infty} (Q_t r_t a_{i,t} + f_i Q_{t+1} [q_{t+1} l_{i,t} + F_i(l_{i,t})]) > 0$ . Hence, there exists a date  $T \geq 1$  such that borrowing constraint (4) is not binding  $\forall t \geq T$ . Therefore,  $r_t \lambda_{i,t} = \lambda_{i,t+1} \forall t \geq T, \forall i$ . By consequence, there exists  $C_i \in (0, \infty)$  such that  $Q_t = C_i \lambda_{i,t} \forall t \geq T$ . According to transversality condition (14), we get  $\lim_{t \rightarrow \infty} Q_t (r_t a_{i,t} + q_t l_{i,t}) = 0$ .

By combining (15) and the fact that  $Q_t = C_i \lambda_{i,t} \forall t \geq T$ , we obtain  $\lim_{t \rightarrow \infty} Q_t c_{i,t} = \lim_{t \rightarrow \infty} Q_t e_{i,t} = 0$ . Therefore, by using budget constraints, we get

$$\lim_{t \rightarrow \infty} Q_t (a_{i,t-1} + q_t l_{i,t-1} + F_i(l_{i,t-1})) = 0.$$

Since  $f_i \in [0, 1]$  and  $Q_t = r_{t-1} Q_{t-1}$ , we obtain the statement (b).

Condition (17) is proved by using the same argument.  $\square$

## B Proofs for Section 3

**Proof of Lemma 2.** According to (11), we obtain  $q_t \geq \gamma_{t+1}(q_{t+1} + \underline{d}_{t+1})$ .

We prove the second inequality. We see that there exists an agent, say  $i$ , such that  $l_{i,t} > 0$ . Thus,  $\eta_{i,t} = 0$ . Therefore, we have

$$\begin{aligned} \lambda_{i,t} q_t &= (\lambda_{i,t+1} + f_i \mu_{i,t+1})(q_{t+1} + F'_i(l_{i,t})) \\ &\leq (\lambda_{i,t+1} + \mu_{i,t+1})(q_{t+1} + F'_i(l_{i,t})) \leq \lambda_{i,t} r_t (q_{t+1} + \bar{d}_{t+1}). \end{aligned} \quad (\text{B.1})$$

By combining with (16), we get the second inequality in (18).

We now prove (19). According to FOCs, we get

$$q_t = \frac{\lambda_{i,t+1} + f_i \mu_{i,t+1}}{\lambda_{i,t+1} + \mu_{i,t+1}} \frac{\lambda_{i,t+1} + \mu_{i,t+1}}{\lambda_{i,t}} (q_{t+1} + F'_i(l_{i,t})) + \frac{\eta_{i,t}}{\lambda_{i,t}} \quad (\text{B.2})$$

$$= \frac{\lambda_{i,t+1} + f_i \mu_{i,t+1}}{\lambda_{i,t+1} + \mu_{i,t+1}} r_t (q_{t+1} + F'_i(l_{i,t})) + \frac{\eta_{i,t}}{\lambda_{i,t}} \quad (\text{B.3})$$

$$\geq f_i r_t (q_{t+1} + F'_i(l_{i,t})). \quad (\text{B.4})$$

Therefore, we obtain (19).  $\square$

**Proof of Lemma 3.** According to (18), we obtain  $d_{t+1} \leq \bar{d}_{t+1}$ .

Since  $f_i = 1 \forall i$  or (4) is not binding for all  $i$ , we always have  $\mu_{i,t+1} = f_i \mu_{i,t+1} \forall i$ . So, we get

$$q_t = \gamma_{t+1}(q_{t+1} + F'_i(l_{i,t})) + \frac{\eta_{i,t}}{\lambda_{i,t}} \geq \gamma_{t+1}(q_{t+1} + F'_i(l_{i,t}))$$

for all  $i$ . Therefore  $d_{t+1} \geq \bar{d}_{t+1}$ . As a result, we have  $d_{t+1} = \bar{d}_{t+1}$ .  $\square$

**Proof of Proposition 2.** Since  $l_{i,t} > 0$  at equilibrium, we have  $\eta_{i,t} = 0$ . By consequence, we obtain that, for all  $i, t$ ,

$$\lambda_{i,t} r_t = (\lambda_{i,t+1} + \mu_{i,t+1}) \quad (\text{B.5})$$

$$\lambda_{i,t} q_t = (\lambda_{i,t+1} + f_i \mu_{i,t+1})(q_{t+1} + F'_i(l_{i,t})). \quad (\text{B.6})$$

We see that, for all  $i, t$ ,

$$\begin{aligned} q_t &= \frac{\lambda_{i,t+1} + f_i \mu_{i,t+1}}{\lambda_{i,t}} (q_{t+1} + F'_i(l_{i,t})) \leq \frac{\lambda_{i,t+1} + \mu_{i,t+1}}{\lambda_{i,t}} (q_{t+1} + F'_i(l_{i,t})) \\ &= \gamma_{t+1}(q_{t+1} + F'_i(l_{i,t})) \end{aligned}$$

Therefore, we obtain that  $q_t \leq \gamma_{t+1}(q_{t+1} + \underline{d}_{t+1})$ . By combining with (18), we have

$$q_t = \gamma_{t+1}(q_{t+1} + \underline{d}_{t+1}).$$

As a result, we get that  $d_{t+1} = \underline{d}_{t+1}$ .  $\square$



**Proof of Proposition 3.** According to FOCs, we obtain

$$1 = \frac{\lambda_{i,t+1} + f_i \mu_{i,t+1}}{\lambda_{i,t+1} + \mu_{i,t+1}} \frac{q_{t+1} + F'_i(l_{i,t})}{q_{t+1} + d_{t+1}} + \frac{\eta_{i,t}}{\lambda_{i,t} q_t} \quad (\text{B.7})$$

If  $l_{i,t} > 0$ , then  $\eta_{i,t} = 0$ . By combining (B.7) with  $f_i \leq 1$ , we get  $d_{t+1} \leq F'_i(l_{i,t})$ .

We now assume that  $d_{t+1} < F'_i(l_{i,t})$ . If (4) is not binding, we have  $\mu_{i,t+1} = 0$  which implies that  $d_{t+1} \geq F'_i(l_{i,t})$ , contradiction.  $\square$

**Proof of Proposition 4.** Since  $f_j = 1$ , condition (11) implies that

$$\frac{q_t}{q_{t+1} + F'_j(l_{j,t})} \geq \frac{\lambda_{j,t+1} + \mu_{j,t+1}}{\lambda_{j,t}} = r_t.$$

Assume that  $l_{i,t} > 0$ , we have  $\eta_{i,t} = 0$  which implies that

$$\frac{q_t}{q_{t+1} + F'_i(l_{i,t})} = \frac{\lambda_{i,t+1} + f_i \mu_{i,t+1}}{\lambda_{i,t}} \leq r_t \leq \frac{q_t}{q_{t+1} + F'_j(l_{j,t})}.$$

Therefore,  $F'_j(L) \leq F'_j(l_{j,t}) \leq F'_i(l_{i,t}) < F'_i(0)$ , contradiction.  $\square$

**Proof of Lemma 4.** Let  $(q, r, (c_i, l_i, a_i), (c_j, l_j, a_j))$  be a steady state equilibrium. According to Proposition 1, we rewrite the system (9, 10, 11, 12, 13)

$$\begin{aligned} \beta_i^t u'_i(c_{i,t}) &= \lambda_{i,t} \\ r_t &= \left( \frac{\beta_i u'_i(c_{i,t+1})}{u'_i(c_{i,t})} + \frac{\mu_{i,t+1}}{\lambda_{i,t}} \right) \\ q_t &= \left( \frac{\beta_i u'_i(c_{i,t+1})}{u'_i(c_{i,t})} + f_i \frac{\mu_{i,t+1}}{\lambda_{i,t}} \right) (q_{t+1} + F'_i(l_{i,t})) + \frac{\eta_{i,t+1}}{\lambda_{i,t}} \\ \eta_{i,t} l_{i,t} &= 0 \\ \mu_{i,t+1} \left( a_{i,t} + f_i [q_{t+1} l_{i,t} + F_i(l_{i,t})] \right) &= 0 \end{aligned}$$

Let us denote  $x_{i,t} := \frac{\mu_{i,t+1}}{\lambda_{i,t}}$ ,  $\sigma_{i,t} := \frac{\eta_{i,t}}{\lambda_{i,t}}$ .

At steady state, we have

$$\begin{aligned} r &= (\beta_i + x_i) \\ q &= (\beta_i + f_i x_i)(q + F'_i(l_i)) + \sigma_i. \end{aligned}$$

Since  $\beta_i < \beta_j$ , we have  $x_i > x_j$ , which implies that  $x_i > 0$ . Therefore, we obtain

$$a_i + f_i [q l_i + F_i(l_i)] = 0.$$

Hence,  $a_i < 0$  and then  $a_j > 0$  which implies that  $x_j = 0$ . The impatient agent borrows from the patient agent.

We consider the case where  $F_i(l_i) = A_i l_i^\alpha$ ,  $F_j(l_j) = A_j l_j^\alpha$ . Then  $F'_h(l_h) = \alpha A_h l_h^{\alpha-1}$  for  $h = i, j$ . In this case, we have  $l_i, l_j > 0$ , hence  $\sigma_i = \sigma_j = 0$ .

We see that  $a_i < 0$ , which implies that  $a_j > 0$ . Hence,  $x_j = 0$ . The asset price is  $r = \beta_j$ . We have  $q \left( \frac{1}{\beta_j} - 1 \right) = F'_i(l_i) = \alpha A_j l_j^{\alpha-1}$ , therefore

$$l_j = \left( \frac{\alpha A_j}{\frac{1}{\beta_j} - 1} \frac{1}{q} \right)^{\frac{1}{1-\alpha}}.$$

Since  $\beta_i + x_i = \beta_j + x_j$ , we get  $x_i = \beta_j - \beta_i$ . By consequence, we can compute

$$l_i = \left( \frac{\alpha A_i}{\frac{1}{\beta_i + f_i(\beta_j - \beta_i)} - 1} \frac{1}{q} \right)^{\frac{1}{1-\alpha}}.$$

Using  $l_i + l_j = L$ , we can compute the price of land

$$q^{\frac{1}{1-\alpha}} L = \left( \frac{\alpha A_i}{\frac{1}{\beta_i + f_i(\beta_j - \beta_i)} - 1} \right)^{\frac{1}{1-\alpha}} + \left( \frac{\alpha A_j}{\frac{1}{\beta_j} - 1} \right)^{\frac{1}{1-\alpha}}.$$

□

## C Proofs for Section 4

**Proof of Proposition 5.** According to (26), it is easy to see that a land bubble exists if and only if  $\lim_{t \rightarrow +\infty} Q_t q_t > 0$ .

According to (25), we get that

$$q_0 = Q_T q_T \prod_{t=1}^T \left( 1 + \frac{d_t}{q_t} \right).$$

Since  $q_0 > 0$ , we see that  $\lim_{t \rightarrow +\infty} Q_t q_t > 0$  if and only if  $\lim_{t \rightarrow \infty} \prod_{t=1}^T \left( 1 + \frac{d_t}{q_t} \right) < \infty$ . It is easy to prove that

this condition is equivalent to  $\sum_{t=1}^{\infty} \frac{d_t}{q_t} < +\infty$ . □

**Proof of Proposition 6.** Assume that  $Q_t/Q_{i,t}$  is uniformly bounded from above. According to Proposition 1, we have  $\lim_{t \rightarrow \infty} Q_{i,t}(q_t l_{i,t} + r_t a_{i,t}) = 0$ , therefore

$$\lim_{t \rightarrow \infty} Q_t(q_t l_{i,t} + r_t a_{i,t}) = \lim_{t \rightarrow \infty} \left( \frac{Q_t}{Q_{i,t}} \right) \left( Q_{i,t}(q_t l_{i,t} + r_t a_{i,t}) \right) = 0$$

for any  $i$ . Note that  $\sum_i l_{i,t} = L > 0$  and  $\sum_i a_{i,t} = 0 \forall t$ , we obtain that  $\lim_{t \rightarrow \infty} Q_t q_t = 0$  □

**Proof of Corollary 5.** Since  $\mu_{i,t+1} = 0 \forall t \geq T$ , we have  $r_t \lambda_{i,t} = \lambda_{i,t+1} \forall t \geq T$ . By consequence,  $\gamma_{i,t} = \gamma_t \forall t \geq T + 1$ . This implies that  $Q_t/Q_{i,t}$  is uniformly bounded from above. According to Proposition 6, there is no bubble. □

**Proof of Lemma 5.** According to (26), we get  $\sum_{t=0}^{\infty} Q_t d_t < \infty$ . However we have  $d_t > F'_i(L) > \min_i F'_i(L) > 0 \forall t$ . Therefore, we obtain  $\sum_{t=0}^{\infty} Q_t < \infty$ . Since  $\sup_{i,t} e_{i,t} < \infty$  and  $F_i(l_{i,t}) \leq F_i(L) \forall i, \forall t$ , we obtain that  $\sum_{t=0}^{\infty} Q_t Y_t < \infty$ . □

**Proof of Lemma 6.** We will claim that  $\sup_{i,t} (Q_t r_t a_{i,t}) < \infty$ . Indeed, (4) is rewritten as

$$Q_{t+1} a_{i,t} + f_i Q_{t+1} (q_{t+1} l_{i,t} + F_i(l_{i,t})) \geq 0. \quad (\text{C.1})$$

Since  $Q_{t+1} = r_t Q_t$ , (4) is equivalent to

$$Q_t r_t a_{i,t} \geq -f_i Q_{t+1} (q_{t+1} l_{i,t} + F_i(l_{i,t})). \quad (\text{C.2})$$

It is easy to see that  $0 \leq Q_t q_t l_{i,t-1} \leq q_0 L < \infty$ . Therefore, we have

$$f_i Q_{t+1} (q_{t+1} l_{i,t} + F_i(l_{i,t})) \leq f_i q_0 L + f_i Q_{t+1} F_i(L). \quad (\text{C.3})$$

By consequence, we obtain

$$Q_t r_t a_{i,t} \geq -f_i q_0 L - f_i Q_{t+1} F_i(L). \quad (\text{C.4})$$

According to the proof of Lemma 5, we see that  $\lim_{t \rightarrow \infty} Q_t = 0$ , and hence we get that  $\inf_{i,t} Q_t r_t a_{i,t} > -\infty$ . Since  $\sum_{i=1}^m Q_t r_t a_{i,t} = 0$ , we have  $-\infty < \inf_{i,t} Q_t r_t a_{i,t} \leq \sup_{i,t} Q_t r_t a_{i,t} < \infty$ .  $\square$

**Proof of Lemma 7.** We rewrite the budget constraint of agent  $i$  at date  $t$  as follows

$$Q_t c_{i,t} + Q_t q_t l_{i,t} + Q_t r_t a_{i,t} = Q_t (e_{i,t} + F_i(l_{i,t-1})) + Q_t q_t l_{i,t-1} + Q_t a_{i,t-1}. \quad (\text{C.5})$$

According to (16) and (20), we get

$$Q_t q_t = Q_{t+1} (q_{t+1} + d_{t+1}), \quad Q_t r_t = Q_{t+1}.$$

Therefore, we have

$$\sum_{t=0}^T Q_t c_{i,t} + \sum_{t=1}^T Q_t d_t l_{i,t-1} + Q_T (q_T l_{i,T} + r_T a_{i,T}) = \sum_{t=0}^T Q_t (e_{i,t} + F_i(l_{i,t-1})) + q_0 l_{i,-1} + a_{i,-1}.$$

By combining this with Lemmas 5 and 6, we obtain that

$$\sup_{T \rightarrow \infty} \left( \sum_{t=0}^T Q_t c_{i,t} + \sum_{t=1}^T Q_t d_t l_{i,t-1} \right) < \infty.$$

This implies that there exists the sum  $\sum_{t=0}^{\infty} (Q_t c_{i,t} + Q_t d_t l_{i,t-1})$ , and so does  $\lim_{t \rightarrow \infty} Q_t (q_t l_{i,t} + r_t a_{i,t})$ .

Note that  $\lim_{t \rightarrow \infty} Q_t c_{i,t} = \lim_{t \rightarrow \infty} Q_t (e_{i,t} + F_i(l_{i,t-1})) = 0$ . Then, by using (C.5), we get (27).  $\square$

**Proof of Lemma 8.** If  $\lim_{t \rightarrow \infty} Q_t (r_t a_{i,t} + q_t l_{i,t}) > 0$ , there exists  $T_1 \geq T$  such that  $Q_t (r_t a_{i,t} + q_t l_{i,t}) > 0 \forall t \geq T_1$ . Hence, we get

$$\begin{aligned} & Q_{t+1} a_{i,t} + f_i Q_{t+1} [q_{t+1} l_{i,t} + F_i(l_{i,t})] \\ & \geq Q_{t+1} a_{i,t} + Q_{t+1} [q_{t+1} + d_{t+1}] l_{i,t} = Q_{t+1} a_{i,t} + Q_t q_t l_{i,t} > 0 \end{aligned}$$

$\forall t \geq T_1$ . This implies that  $\mu_{i,t+1} = 0 \forall t \geq T_1$

Therefore,  $r_t \lambda_{i,t} = \lambda_{i,t+1} \forall t \geq T_1$ . By consequence, there exists  $C_i > 0$  such that  $Q_t = C_i \lambda_{i,t} \forall t \geq T_1$ . According to transversality condition (14), we get  $\lim_{t \rightarrow \infty} Q_t (r_t a_{i,t} + q_t l_{i,t}) = 0$ , contradiction.  $\square$

**Proof of Propostion 7.** If  $l_{i,t} = 0$ , then condition (28) is satisfied.

If  $l_{i,t} > 0$ , by combining with  $f_i = 1$  and using Lemma 3, we have  $d_t = F'_i(l_{i,t-1}) \leq \frac{F_i(l_{i,t-1})}{l_{i,t-1}}$ . Therefore, condition (28) is satisfied. By consequence, we have  $\lim_{t \rightarrow \infty} Q_t (r_t a_{i,t} + q_t l_{i,t}) \leq 0 \forall i$ . By summing this inequality over  $i$ , we obtain  $\lim_{t \rightarrow \infty} Q_t q_t L \leq 0$ , which implies that bubbles are ruled out.  $\square$

**Proof of Proposition 9.** 1. Since  $Q_t \geq Q_{i,t}$ , it is easy to see that  $FV_0 \leq FV_i \forall i$ , and if an  $i$ -land bubble exists for some agent  $i$  then a land bubble exists.

2. Assume that  $i$ -bubble exists for any  $t$ , we have  $\lim_{t \rightarrow \infty} Q_{i,t}q_t > 0 \forall i$ . Therefore, we get  $\lim_{t \rightarrow \infty} Q_tq_t > 0$ . Since both these two limits are finite (less than  $q_0$ ) and strictly positive, we see that  $\lim_{t \rightarrow \infty} Q_t/Q_{i,t} \in (0, \infty) \forall i$ . According to Proposition 6 we have  $\lim_{t \rightarrow \infty} Q_tq_t = 0$ , contradiction.

3. We now assume that  $FV_0 = FV_i \forall i$ , which implies that  $\lim_{t \rightarrow \infty} Q_tq_t = \lim_{t \rightarrow \infty} Q_{i,t}q_t$ . If a land bubble exists, we have  $\lim_{t \rightarrow \infty} Q_tq_t = \lim_{t \rightarrow \infty} Q_{i,t}q_t \in (0, q_0)$ . Thus, we obtain  $\lim_{t \rightarrow \infty} Q_{i,t}/Q_t = 1$ . According to Proposition 6 we have  $\lim_{t \rightarrow \infty} Q_tq_t = 0 = \lim_{t \rightarrow \infty} Q_{i,t}q_t$ , contradiction.  $\square$

## D Proofs for Section 5

First, we give sufficient conditions for a sequence  $(q_t, (c_{i,t}, l_{i,t})_{i \in I})_t$  to be an equilibrium. Notice that the utility function may satisfy  $u_i(0) = -\infty$ .

**Lemma 9.** *If a sequence  $(q_t, (c_{i,t}, l_{i,t}, \mu_{i,t})_{i \in I})_t$  satisfies the following conditions*

$$(i) \quad \forall t, \forall i, c_{i,t} > 0, l_{i,t} \geq 0, \mu_{i,t} \geq 0. \quad \forall t, q_t > 0,$$

(ii) *first-order conditions:*

$$q_t = \frac{\beta_i u'_i(c_{i,t+1})}{u'_i(c_{i,t})} (q_{t+1} + F'_{i,t}(l_{i,t})) + \eta_{i,t}, \quad \eta_{i,t} l_{i,t} = 0, \quad (D.1)$$

(iii) *transversality conditions:*  $\lim_{t \rightarrow \infty} \beta_i^t u'_i(c_{i,t}) q_t l_{i,t} = 0 \forall i$ ,

$$(iv) \quad c_{i,t} + q_t l_{i,t} = e_{i,t} + q_t l_{i,t-1} + F_{i,t}(l_{i,t-1}),$$

$$(vi) \quad \sum_{i \in I} l_{i,t} = L,$$

then the sequence  $(q_t, (c_{i,t}, l_{i,t})_{i \in I})_t$  is an equilibrium for the economy without financial market.

*Proof.* Using the same argument in the proof of Proposition 1.  $\square$

### D.1 Check for the example in Section 5.1.1

We now check all conditions in Lemma 9. It is easy to see that the market clearing conditions are satisfied. Let us check FOCs:

$$q_{2t} = \frac{\beta_B u'_B(c_{B,2t+1})}{u'_B(c_{B,2t})} (q_{2t+1} + B_{2t+1}) \geq \frac{\beta_A u'_A(c_{A,2t+1})}{u'_A(c_{A,2t})} (q_{2t+1} + A_{2t+1}) \quad (D.2)$$

$$q_{2t-1} = \frac{\beta_A u'_A(c_{A,2t})}{u'_A(c_{A,2t-1})} (q_{2t} + A_{2t}) \geq \frac{\beta_B u'_B(c_{B,2t})}{u'_B(c_{B,2t-1})} (q_{2t} + B_{2t}). \quad (D.3)$$

The equality in (D.2) is satisfied because

$$\frac{\beta_B u'_B(c_{B,2t+1})}{u'_B(c_{B,2t})} (q_{2t+1} + B_{2t+1}) = \frac{\beta_B (e_{B,2t} - q_{2t})}{q_{2t+1} + B_{2t+1}} (q_{2t+1} + B_{2t+1}) \quad (D.4)$$

$$= \beta_B (e_{B,2t} - q_{2t}) = q_{2t}. \quad (D.5)$$

We now prove the inequality in (D.2). We have

$$\frac{\beta_A u'_A(c_{A,2t+1})}{u'_A(c_{A,2t})} (q_{2t+1} + A_{2t+1}) = \frac{\beta_A (q_{2t} + A_{2t})}{e_{A,2t+1} - q_{2t+1}} (q_{2t+1} + A_{2t+1}) \quad (D.6)$$

$$= \frac{\beta_A (\frac{\beta_B}{1+\beta_B} e_{B,2t} + A_{2t})}{\frac{1}{1+\beta_A} e_{A,2t+1}} (\frac{\beta_A}{1+\beta_A} e_{A,2t+1} + A_{2t+1}) \quad (D.7)$$

By consequence, the inequality in (D.2) is equivalent to

$$\beta_A \left( \frac{\beta_B e_{B,2t}}{1 + \beta_B} + A_{2t} \right) \left( \frac{\beta_A e_{A,2t+1}}{1 + \beta_A} + A_{2t+1} \right) \leq \beta_B \frac{e_{B,2t}}{1 + \beta_B} \frac{e_{A,2t+1}}{1 + \beta_A} \quad (\text{D.8})$$

which is the condition (31).

We have

$$\frac{\beta_B u'_B(c_{B,2t})}{u'_B(c_{B,2t-1})} (q_{2t} + B_{2t}) = \frac{\beta_B (q_{2t-1} + B_{2t-1})}{e_{B,2t} - q_{2t}} (q_{2t} + B_{2t}) \quad (\text{D.9})$$

$$= \frac{\beta_B \left( \frac{\beta_A}{1 + \beta_A} e_{A,2t-1} + B_{2t-1} \right)}{\frac{1}{1 + \beta_B} e_{B,2t}} \left( \frac{\beta_B}{1 + \beta_B} e_{B,2t} + B_{2t} \right) \quad (\text{D.10})$$

By consequence, the inequality in (D.3) is equivalent to

$$\beta_B \left( \frac{\beta_A e_{A,2t-1}}{1 + \beta_A} + B_{2t-1} \right) \left( \frac{\beta_B e_{B,2t}}{1 + \beta_B} + B_{2t} \right) \leq \beta_A \frac{e_{B,2t}}{1 + \beta_B} \frac{e_{A,2t-1}}{1 + \beta_A} \quad (\text{D.11})$$

which is the condition (32).

We now check TVCs. We have

$$\beta_A^{2t} u'_A(c_{A,2t}) q_{2t} l_{A,2t+1} = 0 \text{ and } \beta_A^{2t-1} u'_A(c_{A,2t-1}) q_{2t-1} l_{A,2t} = \frac{\beta_A^{2t-1}}{c_{A,2t-1}} q_{2t-1} = \beta_A^{2t} \rightarrow 0. \quad (\text{D.12})$$

Similarly, we also have

$$\beta_B^{2t} u'_B(c_{B,2t}) q_{2t} l_{B,2t+1} = \beta_B^{2t+1} \rightarrow 0 \text{ and } \beta_B^{2t-1} u'_B(c_{B,2t-1}) q_{2t-1} l_{B,2t} = 0. \quad (\text{D.13})$$

We finally verify that, for all  $t \geq 0$ ,

$$\frac{\beta_B u'_B(c_{B,2t+1})}{u'_B(c_{B,2t})} \geq \frac{\beta_A u'_A(c_{A,2t+1})}{u'_A(c_{A,2t})} \quad (\text{D.14})$$

$$\frac{\beta_B u'_B(c_{B,2t})}{u'_B(c_{B,2t-1})} \leq \frac{\beta_A u'_A(c_{A,2t})}{u'_A(c_{A,2t-1})}. \quad (\text{D.15})$$

Indeed, condition (D.14) is rewritten as

$$\frac{\beta_B (e_{B,2t} - q_{2t})}{q_{2t+1} + B_{2t+1}} \geq \frac{\beta_A \left( \frac{\beta_B}{1 + \beta_B} e_{B,2t} + A_{2t} \right)}{\frac{1}{1 + \beta_A} e_{A,2t+1}}. \quad (\text{D.16})$$

Since  $q_{2t} = \frac{\beta_B}{1 + \beta_B} e_{B,2t}$ ,  $q_{2t+1} = \frac{\beta_A}{1 + \beta_A} e_{A,2t+1}$ , condition (D.14) is equivalent to

$$\beta_A \left( \frac{\beta_B e_{B,2t}}{1 + \beta_B} + A_{2t} \right) \left( \frac{\beta_A e_{A,2t+1}}{1 + \beta_A} + B_{2t+1} \right) \leq \beta_B \frac{e_{B,2t}}{1 + \beta_B} \frac{e_{A,2t+1}}{1 + \beta_A}. \quad (\text{D.17})$$

This is condition (33).

By the same argument, we see that condition (D.15) is equivalent to

$$\beta_B \left( \frac{\beta_A e_{A,2t-1}}{1 + \beta_A} + B_{2t-1} \right) \left( \frac{\beta_B e_{B,2t}}{1 + \beta_B} + A_{2t} \right) \leq \beta_A \frac{e_{B,2t}}{1 + \beta_B} \frac{e_{A,2t-1}}{1 + \beta_A}. \quad (\text{D.18})$$

This is condition (34).

## D.2 Check for the example in Section 5.2

We will find equilibria such that

$$(l_{A,2t-1}, l_{B,2t-1}) = (0, 1), \quad (l_{A,2t}, l_{B,2t}) = (1, 0) \quad (\text{D.19})$$

$$a_{A,2t-1} = q_{2t} + B_{2t} = -a_{B,2t-1}, \quad a_{B,2t} = q_{2t+1} + A_{2t+1} = -a_{A,2t} \quad \forall t \geq 1. \quad (\text{D.20})$$

It means that at any even (odd) date, agent  $A$  (agent  $B$ ) borrows until her borrowing constraint is binding and buys land.<sup>16</sup> In this case, we have

$$\begin{aligned} \forall t \geq 0, \quad c_{A,2t} + q_{2t} + r_{2t}a_{A,2t} &= e_{A,2t} + a_{A,2t-1} \\ \forall t \geq 0, \quad c_{A,2t+1} + r_{2t+1}a_{A,2t+1} &= e_{A,2t+1} \\ c_{B,0} + r_0a_{B,0} &= e_{B,0} + q_0 + B_0 \\ \forall t \geq 1, \quad c_{B,2t} + r_{2t}a_{B,2t} &= e_{B,2t} \\ \forall t \geq 0, \quad c_{B,2t+1} + q_{2t+1} + r_{2t+1}a_{B,2t+1} &= e_{B,2t+1} + a_{B,2t} \end{aligned}$$

Since  $a_{B,2t} > 0$  and  $a_{A,2t-1} > 0$ , we have  $\mu_{B,2t+1} = \mu_{A,2t} = 0$ . Since agent  $A$  produces at date  $2t + 1$  and agent  $B$  produces at date  $2t$ , we have  $\eta_{A,2t} = \eta_{B,2t-1} = 0$ .

We have to find land prices and interest rates satisfying first-order and transversality conditions.

Transversality conditions (14) are written  $\lim_{t \rightarrow \infty} \beta^t u'_i(c_{i,t})(q_t l_{i,t} + r_t a_{i,t}) = 0 \quad \forall i$ , or equivalently

$$\begin{aligned} \lim_{t \rightarrow \infty} \frac{\beta^{2t}(q_{2t} - r_{2t}(q_{2t+1} + A_{2t+1}))}{e_{A,2t} + (q_{2t} + B_{2t}) - q_{2t} + r_{2t}(q_{2t+1} + A_{2t+1})} &= 0, \quad \lim_{t \rightarrow \infty} \frac{\beta^{2t+1}r_{2t+1}(q_{2t+2} + B_{2t+2})}{e_{A,2t+1} - r_{2t+1}(q_{2t+2} + B_{2t+2})} = 0 \\ \lim_{t \rightarrow \infty} \frac{\beta^{2t}r_{2t}(q_{2t+1} + A_{2t+1})}{e_{B,2t} - r_{2t}(q_{2t+1} + A_{2t+1})} &= 0, \quad \lim_{t \rightarrow \infty} \frac{\beta^{2t+1}(q_{2t+1} - r_{2t+1}(q_{2t+2} + B_{2t+2}))}{e_{B,2t+1} + (q_{2t+1} + A_{2t+1}) - q_{2t+1} + r_{2t+1}(q_{2t+2} + B_{2t+2})} = 0. \end{aligned}$$

FOCs can be rewritten as

$$r_0 = \beta \frac{e_{B,0} + q_0 + B_0 - r_0(q_1 + A_1)}{e_{B,1} + (q_1 + A_1) - q_1 + r_1(q_2 + B_2)} > \beta \frac{e_{A,0} - q_0 + r_0(q_1 + A_1)}{e_{A,1} - r_1(q_2 + B_2)} \quad (\text{D.21})$$

$$\begin{aligned} r_{2t} &= \beta \frac{e_{B,2t} - r_{2t}(q_{2t+1} + A_{2t+1})}{e_{B,2t+1} + (q_{2t+1} + A_{2t+1}) - q_{2t+1} + r_{2t+1}(q_{2t+2} + B_{2t+2})} \\ &> \beta \frac{e_{A,2t} + (q_{2t} + B_{2t}) - q_{2t} + r_{2t}(q_{2t+1} + A_{2t+1})}{e_{A,2t+1} - r_{2t+1}(q_{2t+2} + B_{2t+2})} \end{aligned} \quad (\text{D.22})$$

$$\begin{aligned} r_{2t-1} &= \beta \frac{e_{A,2t-1} - r_{2t-1}(q_{2t} + B_{2t})}{e_{A,2t} + (q_{2t} + B_{2t}) - q_{2t} + r_{2t}(q_{2t+1} + A_{2t+1})} \\ &> \beta \frac{e_{B,2t-1} + (q_{2t-1} + A_{2t-1}) - q_{2t-1} + r_{2t-1}(q_{2t} + B_{2t})}{e_{B,2t} - r_{2t}(q_{2t+1} + A_{2t+1})}. \end{aligned} \quad (\text{D.23})$$

Condition (D.21) means that  $r_0 = \gamma_{B,1} > \gamma_{A,1}$ . Condition (D.22) means that  $r_{2t} = \gamma_{B,2t+1} > \gamma_{A,2t+1}$  while condition (D.23) means that  $r_{2t-1} = \gamma_{A,2t} > \gamma_{B,2t}$ . This implies that  $\gamma_{2t} = \gamma_{A,2t}$  and  $\gamma_{2t+1} = \gamma_{B,2t+1}$ .

It is easy to check that in our example, all first-order and transversality conditions are satisfied.

## E Proofs for Section 6

### E.1 Proof of Proposition 10

We present a proof for the case where there are many consumption goods, the claim of the short-lived asset at node  $\xi$  is a positive vector  $(R_{\xi'})_{\xi' \in \xi^+}$  and production function  $F_{i,\xi}$  are non-stationary.

<sup>16</sup>We need this because Corollary 6 indicates that bubbles only exist if borrowing constraints of agents are frequently binding.

**Point 1.** The proof is far from trivial. Here, we present a proof, inspired by that in [Araujo et al. \(2011\)](#), [Pascoa et al. \(2011\)](#), which is different from that in the deterministic case.

Let  $(p, q, r, (c_i, l_i, a_i)_{i=1}^m)$  be an equilibrium. For each agent  $i$ , we define  $T$ -truncated optimization problem

$$P_i^T(p, q, r) : \max_{(c_i, l_i, a_i) \in B_i^T(p, q, r)} \left[ \sum_{\xi \in D^T} u_{i, \xi}(c_{i, \xi}) \right]$$

where

$$\begin{aligned} B_i^T(p, q, r) := & \{(c, l, a) = (c_\xi, l_\xi, a_\xi)_{\xi \in D^T} : \text{(a) } l_\xi = a_\xi = 0 \ \forall \xi \in D^T, \\ & c_\xi \geq 0, l_\xi \geq 0 \ \forall \xi \in D^T, \\ \text{(b) } & p_{\xi_0} c_{\xi_0} + q_{\xi_0} l_{\xi_0} + r_{\xi_0} a_{\xi_0} \leq p_{\xi_0} e_{i, \xi_0} + p_{\xi_0} F_{i, \xi_0}(l_{\xi_0^-}) + q_{\xi_0} l_{\xi_0^-} \\ \text{(c) } & \forall \xi \text{ such that } 1 \leq t(\xi) \leq T : \\ & 0 \leq p_\xi R_\xi a_{\xi^-} + f_i \left( q_\xi l_{\xi^-} + p_\xi F_{i, \xi}(l_{\xi^-}) \right) \\ & p_\xi c_\xi + q_\xi l_\xi + r_\xi a_\xi \leq p_\xi e_{i, \xi} + p_\xi F_{i, \xi}(l_{\xi^-}) + q_\xi l_{\xi^-} + p_\xi R_\xi a_{\xi^-} \\ \text{(d) } & l_\xi \leq 2L \ \forall \xi \}. \end{aligned}$$

**Lemma 10.** *The problem  $P_i^T(p, q, r)$  has a solution.*

*Proof.* Since all prices and  $R_\xi$  are strictly positive, borrowing constraints imply that  $a_\xi$  is bounded from below. Since  $l_\xi$  is bounded for any  $\xi$ , it is easy to prove, by using the induction argument, that  $a_\xi$  is bounded from above. By consequence,  $c_\xi$  is bounded. Hence,  $B_i^T(p, q, r)$  is bounded and therefore compact.  $\square$

**Remark 7** (on the condition  $l_\xi \leq 2L$  in definition of  $B_i^T(p, q, r)$ ).

If we define  $B_i^T(p, q, r)$  as in [Araujo et al. \(2011\)](#), it will be not easy to prove that  $B_i^T(p, q, r)$  is bounded (because of the presence of short-sales). Indeed, consider a two-period deterministic model; agent  $i$  has linear productivity  $F_i(k) = A_i k$  and  $f_i = 1$ . If prices satisfy  $p_0 = p_1 = 1 = r_0$ ,  $q_0 = 1$ ,  $q_1 = R_1 - A_1 > 0$ , then the following set

$$\begin{aligned} & \left\{ (c_0, c_1, l_0, a_0) : c_0 \geq 0, c_1 \geq 0, l_0 \geq 0 \ \forall \xi \in D^T, \right. \\ & \quad p_0 c_0 + q_0 l_0 + r_0 a_0 \leq p_0 e_{i, 0} + p_0 F_{i, 0}(l_{i, -1}) + q_0 l_{i, -1} \\ & \quad 0 \leq R_1 a_0 + f_i \left( q_1 l_0 + p_1 F_{i, 1}(l_0) \right) \\ & \quad \left. p_1 c_1 \leq p_1 e_{i, 1} + p_1 F_{i, 1}(l_0) + q_1 l_0 + R_1 a_0 \right\} \\ = & \left\{ (c_0, c_1, l_0, a_0) : c_0 \geq 0, c_1 \geq 0, l_0 \geq 0 \ \forall \xi \in D^T, \right. \\ & \quad c_0 + (l_0 + a_0) \leq e_{i, 0} + F_{i, 0}(l_{i, -1}) + l_{i, -1} \\ & \quad 0 \leq (A_i + q_1)(l_0 + a_0) \\ & \quad \left. c_1 \leq e_{i, 1} + (A_1 + q_1)(l_0 + a_0) \right\}. \end{aligned}$$

is not bounded (for example, we can choose  $c_0 = 0, c_1 = 0$  and  $a_0 + l_0 = 0$  with  $a_0$  tends to  $-\infty$  and  $l_0$  tends to  $+\infty$ ).

To encompass this difficulty, unlike [Araujo et al. \(2011\)](#), we impose  $l_\xi \leq 2L$ . This trick helps us to prove the boundedness of  $B_i^T(p, q, r)$ . At the end, this condition can be removed because it is automatically satisfied thanks to the fact that  $l_{i, \xi} \leq L < 2L$  at equilibrium.

We now come back to the proof of Proposition 10. Let  $(c_i^T, l_i^T, a_i^T)$  be a solution of the problem  $P_i^T(p, q, r)$ . The Lagrangian of the problem  $P_i^T(p, q, r)$  is<sup>17</sup>

$$L^T(c, l, a, \lambda_i, \eta_i, \mu_i) = \sum_{\xi \in D^T} u_{i,\xi}(c_\xi) + \sum_{\xi \in D^{T-1}} \eta_{i,\xi}^T l_\xi + \sum_{\xi \in D^{T-1}} \theta_{i,\xi}^T (2L - l_\xi) \quad (\text{E.1})$$

$$\begin{aligned} & + \sum_{\xi \in D^T \setminus \{\xi_0\}} \mu_{i,\xi}^T \left( p_\xi R_\xi a_{\xi^-} + f_i(q_\xi l_{\xi^-} + p_\xi F_{i,\xi}(l_{\xi^-})) \right) \\ & + \sum_{\xi \in D^{T-1}} \lambda_{i,\xi}^T \left( p_\xi e_{i,\xi} + p_\xi F_{i,\xi}(l_{\xi^-}) + q_\xi l_{\xi^-} + p_\xi R_\xi a_{\xi^-} - p_\xi c_\xi - q_\xi l_\xi - r_\xi a_\xi \right) \\ & + \sum_{\xi \in D^T} \lambda_{i,\xi}^T \left( p_\xi e_{i,\xi} + p_\xi F_{i,\xi}(l_{\xi^-}) + q_\xi l_{\xi^-} + p_\xi R_\xi a_{\xi^-} - p_\xi c_\xi \right) \Big]. \end{aligned} \quad (\text{E.2})$$

By using Kuhn-Tucker Theorem and the duality in convex programming in Florenzano and Le Van (2001) (Chapter 7) and Rockafellar (1997) (Chapter 28), there exist non-negative sequences

$$(\lambda_{i,\xi}^T)_{\xi \in D^T}, (\eta_{i,\xi}^T)_{\xi \in D^{T-1}}, (\mu_{i,\xi}^T)_{\xi \in D^T: t(\xi) \geq 1}, (\theta_{i,\xi}^T)_{\xi \in D^{T-1}}$$

such that

$$L^T(c, l, a, \lambda_i^T, \eta_i^T, \mu_i^T, \theta_i^T) \leq L^T(c_i^T, l_i^T, a_i^T, \lambda_i^T, \eta_i^T, \mu_i^T, \theta_i^T) = \sum_{\xi \in D^T} u_{i,\xi}(c_{i,\xi}^T) \leq \sum_{\xi \in \mathcal{D}} u_{i,\xi}(c_{i,\xi}) \quad (\text{E.3})$$

for any  $(c, l, a)$ , where the last inequality in (E.3) is from the optimality of  $(c_i, l_i, a_i)$  for the original problem  $(P_i(p, q, r))$ . This implies that

$$\begin{aligned} & \sum_{\xi \in D^T} u_{i,\xi}(c_\xi) + \sum_{\xi \in D^{T-1}} \eta_{i,\xi}^T l_\xi + \sum_{\xi \in D^{T-1}} \theta_{i,\xi}^T (2L - l_\xi) \\ & + \sum_{\xi \in D^T \setminus \{\xi_0\}} \mu_{i,\xi}^T \left( p_\xi R_\xi a_{\xi^-} + f_i(q_\xi l_{\xi^-} + p_\xi F_{i,\xi}(l_{\xi^-})) \right) \\ & + \sum_{\xi \in D^{T-1}} \lambda_{i,\xi}^T \left( p_\xi e_{i,\xi} + p_\xi F_{i,\xi}(l_{\xi^-}) + q_\xi l_{\xi^-} + p_\xi R_\xi a_{\xi^-} - p_\xi c_\xi - q_\xi l_\xi - r_\xi a_\xi \right) \\ & + \sum_{\xi \in D^T} \lambda_{i,\xi}^T \left( p_\xi e_{i,\xi} + p_\xi F_{i,\xi}(l_{\xi^-}) + q_\xi l_{\xi^-} + p_\xi R_\xi a_{\xi^-} - p_\xi c_\xi \right) \Big] \\ & \leq \sum_{\xi \in \mathcal{D}} u_{i,\xi}(c_{i,\xi}) \quad \text{for any } (c, l, a). \end{aligned} \quad (\text{E.4})$$

By choosing  $c = l = a = 0$  in (E.4), we have, for any  $t \leq T$ ,

$$\sum_{\xi \in D^t} \lambda_{i,\xi}^T p_\xi e_{i,\xi} + \sum_{\xi \in D^{T-1}} \theta_{i,\xi}^T 2L \leq \sum_{\xi \in \mathcal{D}} u_{i,\xi}(c_{i,\xi}) < \infty. \quad (\text{E.5})$$

This implies that  $(\lambda_{i,\xi}^T)_{T \geq t(\xi)}, (\theta_{i,\xi}^T)_{T \geq t(\xi)}$  are bounded node by node.

In condition (E.4), by choosing  $(c, l, a) \in B_i^T(p, q, r)$  such that  $l_\xi = l_{i,\xi_0^-} < L < 2L \forall \xi$ , we have that, for any  $t \leq T$ ,

$$\sum_{\xi \in D^{t-1}} \eta_{i,\xi}^T l_{i,\xi_0^-} + \sum_{\xi \in D^t} f_i \mu_{i,\xi}^T (q_\xi l_{i,\xi_0^-} + p_\xi F_{i,\xi}(l_{i,\xi_0^-})) \leq \sum_{\xi \in \mathcal{D}} u_{i,\xi}(c_{i,\xi}) < \infty. \quad (\text{E.6})$$

Since  $l_{i,\xi_0^-} > 0$ , we obtain that  $(\eta_{i,\xi}^T, \mu_{i,\xi}^T)_{T \geq t(\xi)+1}$  are bounded node by node. So there is a subsequence  $(T_k)_k$  and a non-negative sequence  $(\lambda_{i,\xi}, \eta_{i,\xi}, \mu_{i,\xi}, \theta_{i,\xi})$  such that, for all node  $\xi$ ,

$$(\lambda_{i,\xi}^{T_k}, \eta_{i,\xi}^{T_k}, \mu_{i,\xi}^{T_k}, \theta_{i,\xi}^{T_k}) \longrightarrow (\lambda_{i,\xi}, \eta_{i,\xi}, \mu_{i,\xi}, \theta_{i,\xi}) \text{ when } k \rightarrow \infty.$$

<sup>17</sup>We omit multiplier associated to constraint  $c_{i,\xi} \geq 0$  because at optimal we always have  $c_{i,\xi} > 0$  thanks to Inada condition.



We fixe  $\xi \in D^T \setminus D_T$ . Applying condition (E.4) for  $(c, l, a)$  such that  $(c_\mu, l_\mu, a_\mu) = (c_{i,\mu}, l_{i,\mu}, a_{i,\mu})$   $\forall \mu \neq \xi$ , we have

$$\begin{aligned}
& u_{i,\xi}(c_\xi) + \eta_{i,\xi}^T l_\xi + \theta_{i,\xi}^T (2L - l_\xi) + \lambda_{i,\xi}^T \left( p_\xi c_{i,\xi} + q_\xi l_{i,\xi} + r_\xi a_{i,\xi} - p_\xi c_\xi - q_\xi l_\xi - r_\xi a_\xi \right) \\
& + \sum_{\xi' \in \xi^+} \mu_{i,\xi'}^T \left( p_{\xi'} R_{\xi'} a_\xi + f_i(q_{\xi'} l_\xi + p_{\xi'} F_{i,\xi'}(l_\xi)) \right) \\
& + \sum_{\xi' \in \xi^+} \lambda_{i,\xi'}^T \left( p_{\xi'} F_{i,\xi'}(l_\xi) + q_{\xi'} l_\xi + p_{\xi'} R_{\xi'} a_\xi - p_{\xi'} F_{i,\xi'}(l_{i,\xi}) - q_{\xi'} l_{i,\xi} - p_{\xi'} R_{\xi'} a_{i,\xi} \right) \\
& \leq u_{i,\xi}(c_{i,\xi}) + \sum_{\xi \in \mathcal{D} \setminus D^T} u_{i,\xi}(c_{i,\xi})
\end{aligned} \tag{E.7}$$

From this, we let  $k$  in the subsequence  $(T_k)$  tend to infinity, we obtain that, for any  $(c_\xi, l_\xi, a_\xi)$ ,

$$\begin{aligned}
& u_{i,\xi}(c_\xi) + \eta_{i,\xi} l_\xi + \theta_{i,\xi} (2L - l_\xi) + \lambda_{i,\xi} \left( p_\xi c_{i,\xi} + q_\xi l_{i,\xi} + r_\xi a_{i,\xi} - p_\xi c_\xi - q_\xi l_\xi - r_\xi a_\xi \right) \\
& + \sum_{\xi' \in \xi^+} \mu_{i,\xi'} \left( p_{\xi'} R_{\xi'} a_\xi + f_i(q_{\xi'} l_\xi + p_{\xi'} F_{i,\xi'}(l_\xi)) \right) \\
& + \sum_{\xi' \in \xi^+} \lambda_{i,\xi'} \left( p_{\xi'} F_{i,\xi'}(l_\xi) + q_{\xi'} l_\xi + p_{\xi'} R_{\xi'} a_\xi - p_{\xi'} F_{i,\xi'}(l_{i,\xi}) - q_{\xi'} l_{i,\xi} - p_{\xi'} R_{\xi'} a_{i,\xi} \right) \\
& \leq u_{i,\xi}(c_{i,\xi}).
\end{aligned} \tag{E.8}$$

Choosing  $(c_\xi, l_\xi, a_\xi) = (c_{i,\xi}, l_{i,\xi}, a_{i,\xi})$  and noticing that  $l_{i,\xi} < 2L$ , we have

$$\theta_{i,\xi} = \eta_{i,\xi} l_{i,\xi} = \mu_{i,\xi'} \left( p_{\xi'} R_{\xi'} a_{i,\xi} + f_i(q_{\xi'} l_{i,\xi} + p_{\xi'} F_{i,\xi'}(l_{i,\xi})) \right) = 0 \quad \forall \xi' \in \xi^+. \tag{E.9}$$

By using (E.8) and the definition of derivatives, we also obtain FOCs (51), (52), (53).

Let us now prove transversality condition (56).

**Lemma 11.**  $\limsup_{t \rightarrow \infty} \sum_{\xi \in D_t} \lambda_{i,\xi} (q_\xi l_{i,\xi} + r_\xi a_{i,\xi}) \leq 0$ .

*Proof.* Fixe  $t$ , and take  $T > t$ , we choose  $(c, l, a)$  such that  $(c_\xi, l_\xi, a_\xi) = (c_{i,\xi}, l_{i,\xi}, a_{i,\xi}) \quad \forall \xi \in D^{t-1}$  and  $(c_\xi, l_\xi, a_\xi) = 0$  otherwise, condition (E.4) gives that

$$\sum_{\xi \in D_t} \lambda_{i,\xi}^T \left( p_\xi e_{i,\xi} + p_\xi F_{i,\xi}(l_{i,\xi^-}) + q_\xi l_{i,\xi^-} + p_\xi R_\xi a_{i,\xi^-} \right) \leq \sum_{\xi \in \mathcal{D} \setminus D^{t-1}} u_{i,\xi}(c_{i,\xi}) \quad \forall T. \tag{E.10}$$

Let  $k$  in the subsequence  $(T_k)$  tend to infinity, we have

$$\sum_{\xi \in D_t} \lambda_{i,\xi} \left( p_\xi e_{i,\xi} + p_\xi F_{i,\xi}(l_{i,\xi^-}) + q_\xi l_{i,\xi^-} + p_\xi R_\xi a_{i,\xi^-} \right) \leq \sum_{\xi \in \mathcal{D} \setminus D^{t-1}} u_{i,\xi}(c_{i,\xi}). \tag{E.11}$$

Let  $t$  tend to infinity, notice that  $\sum_{\xi \in \mathcal{D}} u_{i,\xi}(c_{i,\xi}) < \infty$  and  $u_{i,\xi}(c_{i,\xi}) \geq 0$ , we obtain transversality condition

$$\lim_{t \rightarrow \infty} \sum_{\xi \in D_t} \lambda_{i,\xi} \left( p_\xi e_{i,\xi} + p_\xi F_{i,\xi}(l_{i,\xi^-}) + q_\xi l_{i,\xi^-} + p_\xi R_\xi a_{i,\xi^-} \right) = 0. \tag{E.12}$$

Combining this with the fact that budget constraints are always binding, we obtain

$$\limsup_{t \rightarrow \infty} \sum_{\xi \in D_t} \lambda_{i,\xi} (q_\xi l_{i,\xi} + r_\xi a_{i,\xi}) \leq 0. \tag{E.13}$$

□

We have, by noting that  $u_{i,\xi}(0) \geq 0$ ,

$$\infty > \sum_{\xi \in \mathcal{D}} u_{i,\xi}(c_{i,\xi}) \geq \sum_{\xi \in \mathcal{D}} u_{i,\xi}(0) + \sum_{\xi \in \mathcal{D}} u'_{i,\xi}(c_{i,\xi})c_{i,\xi} \geq \sum_{\xi \in \mathcal{D}} \lambda_{i,\xi} p_{\xi} c_{i,\xi}. \quad (\text{E.14})$$

So, we get  $\lim_{t \rightarrow \infty} \sum_{\xi \in D_t} \lambda_{i,\xi} p_{\xi} c_{i,\xi} = 0$ . By combining this with Lemma 11, condition (E.12), and the fact that budget constraints are always binding, we obtain (56) i.e.,  $\limsup_{t \rightarrow \infty} \sum_{\xi \in D_t} \lambda_{i,\xi} (q_{\xi} l_{i,\xi} + r_{\xi} a_{i,\xi}) = 0$ .

**Point 2.** It is sufficient to prove the optimality of  $(c_i, l_i, a_i)$ . This can be proved by using the same argument of the deterministic case.

## E.2 Proof of Proposition 12

First, take  $\gamma$  in Assumption 10, we will prove that  $(1 - \gamma)(q_{\xi} l_{i,\xi} + r_{\xi} a_{i,\xi}) \leq W_{\xi} \forall i, \forall \xi$ .<sup>18</sup> Indeed, suppose that there exist  $i$  and  $\xi$  such that  $(1 - \gamma)(q_{\xi} l_{i,\xi} + r_{\xi} a_{i,\xi}) > W_{\xi}$ . Let us consider a new allocation of agent  $i$ :  $z_i := z(c_i, \xi, \gamma, (1 - \gamma)(q_{\xi} l_{i,\xi} + r_{\xi} a_{i,\xi}))$ . By noticing that  $\gamma < 1$  and  $\gamma F(x) < F(\gamma x) \forall x$ , we can check that this allocation is in the budget set of agent  $i$ . By Assumption 10, we have

$$U_i(c_i) < U_i(z(c_i, \xi, \gamma, W_{\xi})) < U_i(z(c_i, \xi, \gamma, (1 - \gamma)(q_{\xi} l_{i,\xi} + r_{\xi} a_{i,\xi}))). \quad (\text{E.15})$$

This is in contradiction to the optimality of  $(c_i, l_i, a_i)$ .

So, we have  $(1 - \gamma)(q_{\xi} l_{i,\xi} + r_{\xi} a_{i,\xi}) \leq W_{\xi} \forall i, \forall \xi$ . Taking the sum over  $i$ , we get  $(1 - \gamma)q_{\xi} L \leq mW_{\xi} \forall \xi$ . Since  $L(1 - \gamma) > 0$ , we get that

$$q_{\xi} \leq \frac{mW_{\xi}}{L(1 - \gamma)} \forall \xi. \quad (\text{E.16})$$

Point 1 of Proposition 12 is a direct consequence of (E.16).

We now prove point 2 of Proposition 12. Let us consider a process of state-price and land dividend  $\Gamma := (\gamma_{\xi}, d_{\xi})_{\xi \in \mathcal{D}}$ . We will prove that  $\lim_{t \rightarrow \infty} \sum_{\xi \in D_t} Q_{\xi} q_{\xi} = 0$ .

We observe that  $d_{\xi} \geq \inf_{i,\xi} F'_{i,\xi}(l_{i,\xi}) > \inf_{i,\xi} F'_{i,\xi}(L) > 0 \forall \xi$ . Combining this with (64), we have

$$\infty > q_{\xi_0} \geq \sum_{t \geq 1} \sum_{\xi \in D_t} Q_{\xi} d_{\xi} \geq \left( \inf_{i,\xi} F'_{i,\xi}(L) \right) \sum_{t \geq 1} \sum_{\xi \in D_t} Q_{\xi}. \quad (\text{E.17})$$

Therefore,  $\lim_{t \rightarrow \infty} \sum_{\xi \in D_t} Q_{\xi} = 0$ . Since  $W_{\xi}$  is uniformly bounded from above, we get that  $\lim_{t \rightarrow \infty} \sum_{\xi \in D_t} Q_{\xi} W_{\xi} = 0$ . According to point 1, we obtain  $\lim_{t \rightarrow \infty} \sum_{\xi \in D_t} Q_{\xi} q_{\xi} = 0$ .

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<sup>18</sup>Our proof of this claim is inspired by that of Lemma 3.8 in Santos and Woodford (1997). Theorem 1's proof of Pascoa et al. (2011) uses a similar argument.

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