

Correction to Appendix C (Calibration) of “Moral Hazard and the Optimality of Debt”

September 18, 2019

In appendix C of the published version of the paper, there is a missing term in the second equation (the calibration equation). The equation should read

$$\underbrace{\frac{\beta_b \bar{v} - \beta_b E^{p^*}[s_i]}{\beta_b E^{p^*}[s_i]}}_{\text{Spread}} \underbrace{\frac{E^{p^*}[s_i]}{E^{p^*}[v_i]}}_{\text{Share}} \left(1 - \underbrace{\frac{E^{p(\beta_s v)}[v_i] - E^{p^*}[v_i]}{E^{p(\beta_s(v))}[v_i]}}_{\text{Moral Hazard}} \right) \kappa^{-1} \underbrace{(1 + \kappa)}_{\text{Omitted in Published Version}} = \theta.$$

In the calibration, κ is 0.85 percent, so the omitted term affects the calculation by a factor of 1.0085. Given the back-of-the-envelope nature of the statements made in the text, no corrections are necessary to the text of the the appendix or any other part of the paper. The numerical exercises referenced in the text and figures use $\theta = 2$ as a benchmark value, and consequently are unaffected by the correction.

I would like to thank Kevin Lee (currently a Ph. D. student at Chicago Booth) for pointing out this error.