

# Contract Theory

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The purpose of the course is go over the core literature on labor contracts. Other important topics in contract theory which are not directly related to labor relation — for example property right, incomplet contracts, and hold-up problem — will not be covered. This is essentially a readings course, meaning that all participants, including people taking the course or those merely auditing, will have to make presentation. Every paper covered will be explored in depth, and presenters are responsible for all the details of the papers they present, including model, proof, and relation to the literature if possible. Participants are expected to build up a strong background for labor contract theory.

**Gradings:** 60% on presentation, 40% on performance during class.

## Contents

### 1. *Basic Model*

Holmström B. (1979), “Moral Hazard and Observability,” *Bell Journal of Economics*, 10, 74-91.

——— (1982), “Moral Hazard in Teams,” *Bell Journal of Economics*, 13, 324-340.

### 2. *Multi-Agent Model*

Lazear, E. and S. Rosen (1981), “Rank-Order Tournaments as Optimal Labor Contracts,” *Journal of Political Economy*, 89, 841-864.

Green, J. and N. Stokey (1983), “A Comparison of Tournaments and Contracts,” *Journal of Political Economy*, 91, 349-364.

Mookherjee, D. (1984), “Optimal Incentives Schemes with many Agents,” *Review of Economic Studies*, 51, 433-46.\*

### 3. Multi-Task Model

Itoh, H. (1991), "Incentives to Help in Multi-Agent Situations," *Econometrica*, 59, 611-636.

Holmström B. and P. Milgrom (1991) "Multitask Principal-Agent Analyses: Incentive Contracts, Asset Ownership, and Job Design," *Journal of Law, Economics, and Organization*, 7, 24-52.\*

Chen, K.-P. (2003), "Sabotage in Promotion Tournaments," *Journal of Law, Economics and Organization*, 19, 119-140.

Lazear, E. (1989), "Pay Equity and Industrial Politics," *Journal of Political Economy*, 97, 561-580.

### 4. Relationship Contracts

Bull C. (1987), "The Existence of Self-Enforcing Implicit Contracts," *Quarterly Journal of Economics*, 102, 147-59.

MacLeod, B. and J. Malcolmson (1989), "Implicit Contracts, Incentive Compatibility, and Involuntary Unemployment," *Econometrica*, 57, 447-480.\*

Levin, J. (2003), "Relational Incentive Contracts," *American Economic Review*, 93, 835-857.\*

### 5. Subjective Evaluation

MacLeod, B. (2003), "Optimal Contracting with Subjective Evaluation," *American Economic Review*, 93, 216-240 .

Baker, G., R. Gibbons and K.J. Murphy (1994), "Subjective Performance Measures in Optimal Incentive Contracts," *Quarterly Journal of Economics*, 109, 1125-1156.

Fuchs, W. (2007), "Contracting with Repeated Moral Hazard and Private Evaluations," *American Economic Review*, 97, 1432-1448.\*

\* Papers with asterisks are to be presented by students.