

University of Paris-Saclay

Master in Economics

ENSAE

Year 2017-2018

Fall 2017

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THEORY of CONTRACTS and INCENTIVES

The course will focus on basic building blocks in the Theory of Incentives, with applications to the firm, organizations and labour contracts.

Course Outline

Part 1. The Principal-Agent Model under Pure Moral Hazard

Mirrlees' Model --- Grossman and Hart's approach --- The first-order approach --- Holmström's Informativeness Principle --- The Multitask Agent Problem.

Part 2. The Principal-Agent Problem under Pure Adverse Selection

Discrimination under incomplete information --- the Rent extraction problem --- Informational Rents and Second-best distortions --- Countervailing incentives --- Application to Optimal Regulation --- Baron and Myerson's Model --- Laffont and Tirole's Model.

Part 3. Incentives in Teams

Incentives in Teams: Coordination and Authority --- Teams with incomplete information --- Yardstick Competition --- Tournaments

Part 4. Introduction to Dynamic Problems

Implicit or Self-enforcing contracts --- Efficiency Wages à la Shapiro-Stiglitz--- MacLeod and Malcomson's Complete Information Model --- Theory of Career Concerns --- Implicit and Explicit Incentives combined --- Relational Contracts (under Incomplete Information).

REFERENCES

Textbooks

Patrick Bolton and Mathias Dewatripont (2004), *Contract Theory*, MIT Press, Cambridge, Mass.

Jean-Jacques Laffont and David Martimort (2001), *The Theory and Incentives*, Princeton University Press, Princeton.

Edward P. Lazear (1995), *Personnel Economics*, MIT Press, Cambridge, Massachusetts.

Bernard Salanié (2005), *The Economics of Contracts: a Primer*, new edition, MIT Press.

Some Classic Articles

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

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Rogerson, William P. (1985), "The First-Order Approach to Principal-Agent Problems," *Econometrica*, **53**, 1357-1368.

Shapiro, Carl and Joseph E. Stiglitz (1984), "Equilibrium Unemployment as a Worker Discipline Device," *American Economic Review*, **74**, 433-444.