

Economics Seminar, Indian Statistical Institute, New Delhi.

SPEAKER: **Subir K. Chakrabarti**, Indiana University Purdue University Indianapolis

TITLE: **Long Run Optimal Contracts under Adverse Selection with Limited Commitment**

TIME: 11:30 AM - 1:00 PM.

DAY & DATE: Monday, 13th July, 2012

PLACE: Seminar Room 2

Abstract:

The paper studies long run optimal contracts under adverse selection with limited commitment so that the contracts are open to negotiation in every period. Thus the contracting game is repeated over multiple periods and belief about the type of the agent is updated by the principal. We study both the finite-horizon case as well as the infinite-horizon case and find that the unique perfect Bayesian equilibrium of the finite horizon repeated contracting game is one in which the second-best optimal contract is offered in period 1, there is full revelation of the type of the agent, and from period 2 onwards the first-best contract is offered by the principal. If the agent is the least efficient type then the agent gets no informational rent but if the type of the agent is among the more efficient types, the agent receives an informational rent that has to be paid in period 1. By contrast the infinite-horizon game has multiple Perfect Bayesian Equilibrium points and the one that is optimal for the principal is the equilibrium in which the principal offers the type-separating second-best optimal contract in period 1, fully updates beliefs about the type of the agent and continues to offer the second-best contract from period 2 onwards.

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