This course describes several prominent theories of contracting, but this is not a standard course in contract theory. Instead, the theories are chosen because of their existing and potential applications – as applied theory in fields such as IO, labor, macro, corporate finance, and organizations, and also as empirical work in such fields. In short, this course is an attempt to define and develop “contract economics,” rather than a conventional exposition of contract theory.

The prerequisite for this course is 14.124. That is, we presume a solid background in the basics of uncertainty, statistical decision theory, risk aversion, moral hazard, adverse selection, signaling and auctions, at the level of Mas Colell, Whinston, and Green (Chapters 6, 13, 14, and 23).

The structure of the course is as follows:

I. Incentives
   A. Formal Contracts
   B. Relational Contracts
   C. No Contracts: Career Concerns and Reputation

II. Decision Rights
   A. Classics
   B. Ex Ante Incentives
   C. Ex Post Control

III. Dynamic Contracting
   A. Renegotiation and Incomplete Contracting
   B. Dynamic Risk-Sharing and Moral Hazard
   C. Dynamic Financial Contracting

IV. Multi-Agent Contracting

Many of the readings are available on the web and can be accessed from the course web page. Readings marked with an asterisk are required: Those marked *W are available on the web; those marked *P are available in the course packet from Copy Tech (E52, basement).
There will be several problem sets, which will be corrected but not counted. The grade will depend solely on the final exam. Completing the problem sets is virtually a necessary condition for doing well on the exam.

This course is a prerequisite for two courses in Spring ’04: Organizational Economics (14.282, R. Gibbons) and Advanced Contract Theory (14.129, P. Legros and H. Ergin). There are two minor fields that involve these courses: (1) 14.281 and 14.282 can be taken as a minor field in Contracts and Organizations; (2) 14.129 can be taken as one of the two courses constituting a minor field in Advanced Economic Theory (but 14.281 cannot count as one of these courses). Finally, there will be three questions on the Theory General Exam from 14.281 and 14.129: one from 14.281, one from H1 of 14.129, and one from H2 of 14.129.

I. Incentives

A. Formal Contracts (Sept. 3, 8, 10, 15)

1. Basic Theory


Fehr, Ernst and Klaus Schmidt. 2003. “Fairness and Incentives in a Multi-Task Principal-Agent Model.” mimeo, University of Zurich.

2. Evidence and Applications


3. Multiple Agents

*P Bolton, P. and M. Dewatripont (2001), Introduction to Contract Theory (manuscript), Chapter 9 (Multiagent Moral Hazard and Collusion)


B. Relational Contracts (Sept. 17, 24, 29)


C. No Contracts: Career Concerns and Reputation (Oct. 1, 6, 8)


II. Decision Rights

A. Classics (Oct. 15)


B. Ex Ante Incentives (Oct. 20, 22, 27)


**C. Ex Post Control (Oct. 29, Nov. 3)**


III. Dynamic Contracting

A. Renegotiation and Incomplete Contracting (Nov. 5, 12)


B. Dynamic Risk-Sharing and Moral Hazard (Nov. 17, 19, 24)


*P Bolton, P. and M. Dewatripont (2001), Introduction to Contract Theory (manuscript), Chapter 13 (Dynamic Moral Hazard).


C. Dynamic Financial Contracts (Nov. 26, Dec. 1)


**IV. Multi-Agent Contracting (Dec. 3, 8, 10)**

Bolton, P. and M. Dewatripont (2001), *Introduction to Contract Theory* (manuscript), Chapter 9 (Multiagent Moral Hazard and Collusion)


