

Contents

Foreword to the Second Edition ix

Foreword to the First Edition xi

1 Introduction 1

1.1 The Great Families of Models 3

1.2 The Principal–Agent Model 5

1.3 Overview of the Book 6

References 8

2 Adverse Selection: General Theory 11

*2.1 Mechanism Design 13

2.1.1 *General Mechanisms* 15

2.1.2 *Application to Adverse Selection Models* 16

2.2 A Discrete Model of Price Discrimination 18

2.2.1 *The Consumer* 19

2.2.2 *The Seller* 19

2.2.3 *The First-Best: Perfect Discrimination* 20

2.2.4 *Imperfect Information* 21

2.3 The Standard Model 27

2.3.1 *Analysis of the Incentive Constraints* 29

2.3.2 *Solving the Model* 33

Exercises 40

References 42

3 Adverse Selection: Examples and Extensions 43

3.1 Examples of Applications 43

3.1.1 *Regulating a Firm* 43

3.1.2 *Optimal Taxation* 47

3.1.3	<i>The Insurer as a Monopolist</i>	51
3.2	Extensions	57
3.2.1	<i>Perfect Competition in Contracts</i>	57
*3.2.2	<i>Multiple Principals</i>	61
3.2.3	<i>The Theory of Auctions</i>	65
3.2.4	<i>Collusion</i>	73
3.2.5	<i>Risk-Averse Agents</i>	76
*3.2.6	<i>Multidimensional Characteristics</i>	78
3.2.7	<i>Bilateral Private Information</i>	82
3.2.8	<i>Type-Dependent Reservation Utilities</i>	88
3.2.9	<i>Auditing the Agent</i>	89
	Exercises	91
	References	93
4	Signaling Models	97
4.1	The Market for Secondhand Cars	98
4.2	Costly Signals	99
4.2.1	<i>Separating Equilibria</i>	102
4.2.2	<i>Pooling Equilibria</i>	103
4.2.3	<i>The Selection of an Equilibrium</i>	103
4.3	Costless Signals	107
4.3.1	<i>A Simple Example</i>	108
4.3.2	<i>The General Model</i>	109
4.4	Other Examples	114
4.5	The Informed Principal	116
	Exercises	117
	References	118
5	Moral Hazard	119
5.1	A Simple Example	122
5.2	The Standard Model	124
5.2.1	<i>The Agent's Program</i>	125
5.2.2	<i>The Principal's Program</i>	126
5.2.3	<i>Properties of the Optimal Contract</i>	129
5.3	Extensions	134
5.3.1	<i>Informativeness and Second-Best Loss</i>	134
5.3.2	<i>A Continuum of Actions</i>	135
5.3.3	<i>The Limited Liability Model</i>	136

*5.3.4	<i>An Infinity of Outcomes</i>	138
5.3.5	<i>The Multisignal Case</i>	139
5.3.6	<i>Imperfect Performance Measurement</i>	140
5.3.7	<i>Models with Several Agents</i>	140
5.3.8	<i>Models with Several Principals</i>	142
*5.3.9	<i>The Robustness of Contracts</i>	144
5.3.10	<i>The Multitask Model</i>	146
5.4	<i>Examples of Applications</i>	149
5.4.1	<i>Insurance</i>	149
5.4.2	<i>Wage Determination</i>	151
	<i>Exercises</i>	156
	<i>References</i>	159
6	The Dynamics of Complete Contracts	161
6.1	<i>Commitment and Renegotiation</i>	162
6.2	<i>Strategic Commitment</i>	164
6.3	<i>Adverse Selection</i>	168
6.3.1	<i>Full Commitment</i>	170
6.3.2	<i>Long-Term Commitment</i>	172
6.3.3	<i>No Commitment</i>	176
6.3.4	<i>Short-Term Commitment</i>	177
6.3.5	<i>Conclusion</i>	178
6.4	<i>Moral Hazard</i>	179
6.4.1	<i>Renegotiation after Effort</i>	179
*6.4.2	<i>Convergence to the First-Best</i>	181
6.4.3	<i>Finitely Repeated Moral Hazard</i>	183
	<i>References</i>	190
7	Incomplete Contracts	193
7.1	<i>Property Rights, Holdup, and Underinvestment</i>	195
7.1.1	<i>The Buyer–Seller Model</i>	196
7.1.2	<i>The Complete Contract</i>	197
7.1.3	<i>Incomplete Contracts and Property Rights</i>	198
7.2	<i>The Irrelevance Theorems</i>	200
7.2.1	<i>Restoring Efficient Investment Incentives</i>	200
7.2.2	<i>Using Mechanism Design</i>	204
7.3	<i>Concluding Remarks</i>	205
	<i>References</i>	209

8 Some Empirical Work	211
8.1 Dealing with Unobserved Heterogeneity	212
8.2 Auctions	216
8.3 Tests of Asymmetric Information in Insurance Markets	218
References	221
Appendix: Some Noncooperative Game Theory	223
A.1 Games of Perfect Information	224
A.1.1 Nash Equilibrium	224
A.1.2 Subgame-Perfect Equilibrium	224
A.2 Games of Incomplete Information	226
A.2.1 Bayesian Equilibrium	226
A.2.2 Perfect Bayesian Equilibrium	227
A.2.3 Refinements of Perfect Bayesian Equilibrium	229
References	232
Name Index	233
Subject Index	235