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Presentation Title

Relational Contracts: Public versus Private Savings

(with Daniel Garrett)

Abstract

We study relational contracting with an agent who has consumption-smoothing preferences as well as the ability to save to defer consumption (or to borrow). Our focus is the comparison of principal-optimal relational contracts in two settings. The first where the agent's consumption and savings decisions are private, and the second where these decisions are publicly observed. In the first case, the agent smooths his consumption over time, the agent's effort and payments eventually decrease with time, and the balances on his savings account eventually increase. In the second, the agent consumes earlier than he would like, consumption and the balance on savings fall over time, and effort and payments to the agent increase. Our results suggest a possible explanation for low savings rates in certain industries where compensation often comes in the form of discretionary payments.

Keywords

Relational contracts; Consumption smoothing preferences; Private savings

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