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Renegotiation-Proof Relational Contracts with Side Payments

Abstract

We study infinitely repeated two player games with perfect monitoring in which the players have the possibility to make monetary transfers to each other. We show that in order to find all Pareto-optimal subgame perfect payoffs for a given discount factor, one may restrict attention to a special class of subgame perfect equilibria which we call stationary contracts. We also examine different concepts of renegotiation-proofness and extend the result to renegotiation-proof payoffs. These results are useful because we arrive at simple conditions that characterize both Pareto-optimal and renegotiation-proof stationary contracts, which can therefore be found easily in many applications.