On incentives, temptation and self-control

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Abstract

We consider a principal-agent model, where a single agent exhibits problems of self control modelled using Gul, Pesendorfer (2001) type temptation preferences. For a general class of preferences, yet specific family of temptation utilities, we characterize an optimal contract in such a setting using standard Grossman, Hart (1983) techniques. Firstly, our analysis shows that contrary to standard results for the separable utility the first best solution may provide a variable pay. Secondly, in the second best the incentive compatibility constraint is not necessarily binding. These observations result from the fact that, in our setting, principal trade-offs incentives and insurance but also reduction of self control costs for the agent. We also show how are results can be extended to the multi-action case and more general temptation utilities. Our new results shed some light on the justification of randomized contracts (see Holmstrom (1979)), the literature on behavioral contracts, but also show that in the presence of strong self-control costs both first and second best coincide, and moral hazard cost is mitigated.

keywords: self-control costs, temptation, principal-agent, optimal contract, randomized contracts, behavioral contracts

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