

THREE ESSAYS ON BEHAVIOURAL CONTRACT THEORY

**ADDENDUM SUBMITTED TO JADAVPUR UNIVERSITY, KOLKATA FOR THE DEGREE OF
DOCTOR OF PHILOSOPHY (ARTS)**

by

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Addendum to Chapter 1: Overview

1.2. Survey of Literature

They also show that envy tightens the worker's participation constraint and calls for higher pay and a softer effort requirement. Englmaier and Leider (2008) incorporate reciprocal preferences in line with Rabin (1993), Dufwenberg and Kirchsteiger (2004) and Falk and Fischbacher (2006) into a moral hazard framework and derive properties of the optimal contract and implications for organizational structure but with a self-regarding principal.

There are several papers that deal with multi-agent problems in principal agent model.

1.3. Motivation and Outline of the Thesis:

Recent literature and experiments have also suggested the presence of social comparison in human decision making. Fehr and Charness (2023) have made an extensive survey of the vast literature of social preferences and its consequences on important economic and political behaviour. Their findings suggest that majority of individuals have some type of social preference while purely self-interested subjects are a minority. In their paper they have classified the experimental literature of Equality Equivalence Test (EET) in two broad categories – experiments run on student samples and experiments run on nationally representative samples. They have found that the share of selfish individuals is much larger in the student samples than the nationally representative samples. In nationally representative samples, self-interestedness varies between 5% to 20%. This is because in nationally representative samples the percentage share of inequality averse individuals is very high. The share of spiteful/envious subjects is also higher in the nationally representative samples (on an average of 11.5%) compared to the student samples (average 5%). The general population is more other-regarding and especially inequality averse and spiteful/envious than the student subjects. However, altruism is more common in student samples.

Addendum to Chapter 2: Optimal Incentive Contracts with a Spiteful

Principal: Single Agent (Discrete Outcomes)

2.1. Introduction:

We model other regarding preferences in line with the distributional approach a la Fehr and Schmidt (1999) and Nelson and Stowe (2003). The concept and functional form coined by Fehr and Schmidt (1999) has been used. They have modelled fairness as self-interested inequity aversion. In their words, inequity aversion is when people resist inequitable outcomes or they are willing to give up some material payoff to move in the direction of more equitable outcomes. Inequity aversion can be self-centred if one doesn't care about the inequality that exists among other people or among the society in general but is only interested in the fairness of their own material payoff relative to the payoff of others. They have shown that heterogeneity of preferences interacts in interesting ways with the economic environment.

2.2. The Self-interested Benchmark:

The above incentive compatibility constraint can be written as $e = (w_s - w_f) = \Delta w$ (let).

2.3.1. Alternative Specification:

In an alternative specification of the above model, we assume that the principal compares his payoff $(b - w_s)$ with agent's net payoff i.e., $(w_s - \frac{e^2}{2})$ making him a benign principal since the net payoff is lesser than the agent's actual payoff. In this case, the principal takes into account the effort cost elicited by the agent while comparing the payoff differences between them. Earlier the payoff difference was considered to be $(b - 2w_s)$, but under this specification the effort cost of $\frac{e^2}{2}$ is also subtracted from the actual payoff difference of $(b - 2w_s)$, thus making the principal 'benign'. The principal's other-regardingness will be comparatively lower under this specification than the earlier framework.

Addendum to References:

Fehr, E., & Charness (2023). Social Preferences: Fundamental Characteristics and Economic Consequences. *CESifo Working Paper* 10488.

Sanyal, S., & Hisam, M.W. (2018). The Impact of Teamwork on Work Performance of Employees: A Study of Faculty Members in Dhofar University.