

Flexible Renegotiation and Persistent Private Information

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Abstract

Models of renegotiation that restrict the number of renegotiation opportunities implicitly assume some commitment, and can result in violations of the renegotiation-proofness principle and in ex post inefficiency. By removing such restrictions, flexible renegotiation leads to a simpler and more tractable analysis, restoring both the principle and efficiency, and provides an explicit foundation for set theoretic definitions of renegotiation-proofness. In dynamic contracting problems with persistent private information, renegotiation-proof contracts are separating if the agent is sufficiently risk averse or if persistence is weak. A cost-weighted Euler equation holds, which reflects the principal's value for future outcomes. With constant absolute risk aversion, renegotiation-proof contracts are separating and the standard Euler equation holds.