

The Ratchet Effect Re-examined:  
A Learning Perspective

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This talk is based on two papers that examine the ratchet effect in a situation where both principal and agent are uncertain about the difficulty of the job, and must learn this over time. The first (joint with George Mailath) examines the dynamic moral hazard problem when the choice of effort is binary and the principal seeks to induce high effort. Since the agent can always increase his future continuation value by shirking today, this must be deterred by higher powered incentives today. However, high powered incentives in any period increase deviation gains in previous periods, so that the incentive problem becomes harder with the length of the time horizon. The second paper examines optimal contracting with a continuum of effort levels, and proves an impossibility result: no interior effort level is implementable in the absence of commitment.