Motivating versus Funding

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Abstract

We consider a moral hazard problem where the agent’s effort induces monetary costs, and limits on the agent’s resource restrict his capability to exert effort. The optimal contract is, in some cases, a sharing contract and the principal provides the agent with an up-front financial transfer. Moreover, whereas incentives and transfer to the agent are substitutes in the case where he has sufficient wealth, they are complements when his wealth is limited. Also, if the agent can consume some of his wealth at the outset of the contractual arrangement, he can get all the surplus of the relationship.

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