Contracts and Money[1]

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ABSTRACT: We study the principal-agent problem when there is nominal risk. We find that when nominal data are gathered with delay, fully indexed contracts are not time consistent, not renegotiation proof. Instead, renegotiation-proof contracts *overcompensate* for nominal risk, and pay risk-averse agents more in times of unexpected inflation. In general equilibrium, monetary expansions help workers and hurt shareholders. This fits the stylized facts that surprise inflation raises labor's share on one hand, and lowers stock returns on the other. A constant, or a predictable rule strictly Pareto dominates random money-supply rules.

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