

Strategic Delegation By Unobservable Incentive Contracts*

Levent Koçkesen[†] Efe A. Ok[‡]

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Abstract

Many strategic interactions in the real world take place among delegates empowered to act on behalf of others. Although there may be a multitude of reasons why delegation arises in reality, one intriguing possibility is that it yields a strategic advantage to the delegating party. We analyze the possibility that strategic delegation arises as an equilibrium outcome under completely unobservable incentive contracts within the class of two-person extensive form games with perfect information. We show that delegation *may* arise solely due to strategic reasons in quite general economic environments even under unobservable contracts. Furthermore, under some reasonable restrictions on out-of-equilibrium beliefs and actions of the outside party, strategic delegation is shown to be the *only* equilibrium outcome.

JEL Classification: C72, D80.

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[†]Department of Economics, New York University, 269 Mercer Street, New York NY 10003. E-mail: kockesen@fasecon.econ.nyu.edu.

[‡]Department of Economics, New York University, 269 Mercer Street, New York NY 10003. E-mail: okefe@fasecon.econ.nyu.edu.