

AGENT COMPENSATION AND THE LIMITS OF BONDING

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Abstract

Agents in positions of trust may engage in malfeasance which is difficult to detect. This paper develops a model in which employers seek to control malfeasance by paying wages contingent on imperfect monitoring and agents may be required to pay entry fees or post bonds. We conclude that entry fees which exceed agents' assets are ineffective in controlling malfeasance. As a result, conditions exist in which it is optimal to pay agents more than their opportunity cost. Such conditions lead to an excess supply of applicants and allow employers to engage in discrimination at zero cost to themselves.

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