

Indenture as a Commitment Device in Self-Enforced Contracts: An Experimental Test

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Abstract

How can a principal (an agent) ensure that an agent (a principal) will work (pay up), if payment (work) precedes work (payment)? When a banknote is torn in two, each part is by itself worthless. A principal can pre-commit to payment-on-delivery, by tearing a banknote and giving the agent the first half as “prepayment”; the agent receives the completing half upon delivery of the service. This contract design is known as “indenture”. It is self-enforcing and incentive-compatible. This paper experimentally tests the efficacy of the “indenture game” and its implications for cooperation in one-shot environments. We find that cooperation rates are high and stable over time. Its efficacy is moderated by expected losses due to the existence of uncooperative types.