

Abstract

We study a repeated principal-agent interaction, in which the principal offers a "spot" wage contract at every period, and the agent's outside option follows a Markov process with i.i.d shocks. If the agent rejects an offer, the two parties are permanently separated. At any period during the relationship, the agent is productive if and only if his wage does not fall below a "reference point" (by more than an infinitesimal amount), which is defined as his lagged-expected wage in that period. We characterize the game's unique subgame perfect equilibrium. The equilibrium path exhibits an aspect of wage rigidity. The agent's total discounted rent is equal to the maximal shock value.