Ex Ante Collusion and Design of Supervisory Institutions

Dilip Mookherjee, Boston University
Alberto Motta, University of New South Wales
Masatoshi Tsumagari, Keio University

Abstract

A Principal seeks to design a mechanism for an agent (with privately informed cost) and a supervisor/intermediary (with a noisy signal of the agent's cost) that collude on *both* participation and reporting decisions. Under weak belief restrictions which generalize the assumption of passive beliefs, the problem reduces to selecting weakly collusion-proof (WCP) allocations that satisfy interim participation constraints. We characterize WCP allocations, and use this to show that it is valuable to employ the supervisor. Delegation is optimal, but only if supplemented by an appeal/dispute settlement mechanism mediated by the Principal, which serves as an outside option for coalitional bargaining.