Asymmetric Productivities
and
Default Incomplete Contracts

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Abstract: We study a situation where two players with asymmetric productivities first bid for a sharing rule, then invest into a joint production process, and then split joint benefits. An "efficient" contract provides optimal incentives, a "fair" contract splits the joint production evenly. Although in equilibrium both types of players benefit from an efficient contract, weak (less productive) types expect to gain more from a fair contract and, hence, mainly bid for such a fair contract. Only strong (more productive) players bid for the "efficient" contract which would provide optimal incentives. Expectations are not rational. Weak players would gain more from an efficient contract than they actually expect while strong players underestimate the potential gains from a fair contract. A considerable fraction of players does not bid at all for their preferred contract. As a result, the default contract matters.