S. Morfov
Optimal Tenure Decisions

This paper formally analyzes the dynamic implementation of compensation schemes with characteristics inherent to academic tenure. We consider a moral hazard problem in a principal-agent setting with limited commitment and fluctuating outside options. The tenure decision once taken forces the principal to honor a long-term contract providing the agent with compensation that cannot decrease in time. We reduce the dynamic problem to a series of single-period problems stationary on a properly chosen state space. The representation allows for computing the model iteratively. We use numerical experiments to investigate the conditions under which granting tenure appears optimal. This provides us with some important intuition about the role of tenure as an insurance vehicle, the scope of compatible incentives, and its cost of implementation. By simulating time paths according to the optimal policy and the related law of motion under the tenure contract, we are able to analyze the dynamics and the long-term behavior of the scheme.