THE BEHAVIORAL EFFECTS OF WAGE AND EMPLOYMENT POLICIES
WITH GIFT EXCHANGE PRESENT

DISSERTATION

Presented in Partial Fulfillment of the Requirements for
the Degree Doctor of Philosophy in the Graduate
School of The Ohio State University

By

Mark F. Owens, M.A.

* * * * *

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Dissertation Committee:

Approved by

Professor John H. Kagel, Advisor
Professor Patricia B. Reagan
Professor Howard P. Marvel

Advisor
Economics Graduate Program
ABSTRACT

The importance of psychological factors in many economic situations is not fully understood. This dissertation examines how the outcomes relating to minimum wage and employment subsidy policies may be influenced by the perceptions that workers have about such policies. Issues regarding these effects on policy have not received much attention in the economics literature. This dissertation first presents an introduction and a brief review of the literature relating to gift exchange, the influence of reference points in decision making, and policy issues. Then it presents results from laboratory experiments conducted in order to test the effects of the minimum wage and employment subsidy policies in markets where employees have preferences for fairness and reciprocity that go beyond the standard model of rational self interest.

Results are presented from experiments which introduce minimum wage restrictions into an experimental labor market characterized by gift exchange between employers and employees. Experiment 1 shows that introducing a minimum wage into an ongoing labor market has an overall positive effect on employee effort as there is a small, statistically insignificant, negative effect on effort at low wages, and a larger, statistically significant, positive effect at higher wages. However, in comparing a labor market that starts with a minimum wage versus one that does not, the minimum wage results in sharply reduced effort. (i) These differences in results are entirely consistent with the
decision theoretic research on reference point effects and (ii) the response to the minimum wage within an ongoing labor market has greater “ecological validity” for evaluating the likely impact outside the lab. Experiment 2, using payoff functions that make gift exchange more costly relative to Experiment 1 to both employers and employees, confirms that the effects of a minimum wage on effort within an ongoing labor market are unlikely to have a major adverse effect on employee effort.

Findings from another experiment that introduces an employment subsidy into an experimental labor market characterized by gift exchange between employers and employees are also presented. Initially the market has substantial unemployment and significant levels of gift exchange. Then, an employment subsidy is introduced into the market to eliminate the unemployment. The results indicate that the subsidized workers do not respond differently from the unsubsidized workers when the subsidy is introduced. However, there is some evidence that workers who are already employed reduce their effort from previous levels when the subsidy is introduced. These results suggest that employee perceptions may play a role when employment subsidies are introduced into labor markets with gift exchange.

These experiments examine the influence that two external policies have in markets that are characterized by other regarding preferences and they offer insight into some behavioral issues that may arise beyond standard economic theory.
Dedicated to my wife Monica
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VITA

November 9, 1978..........................Born – Erie, Pennsylvania

2001........................................B.S. Economics, Saint Vincent College

2002........................................M.A. Economics, The Ohio State University

2001 – present..........................Graduate Teaching and Research Associate,
                                           The Ohio State University

FIELDS OF STUDY

Major Field: Economics
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CHAPTER 1

INTRODUCTION AND REVIEW OF LITERATURE

1.1 INTRODUCTION

The notion that efficiency wages may encourage employees to work harder has received a great deal of attention in the economics literature. Many empirical, theoretical, and experimental studies have suggested that an employee’s response to a wage depends in part on its relative position on the wage distribution. There is evidence that workers earning relatively more often provide greater effort on the job in return.

While the relationship between wages and effort has been thoroughly researched, far less is known about the effects that various policies intended to influence wages and employment may have on employee wage perceptions. Since many of these policies impact relative wages, any changes in employee perceptions can potentially influence the efficiency of the policy. It is possible that higher relative wages that are offered by an employer may be met with different levels of appreciation depending on the wage policy that is present when the wage is determined.

The focus of this research is one type of efficiency wage known as the gift-exchange hypothesis (Akerlof, 1982). In this model firms offer the “gift” of a high wage to workers in order to increase worker effort and the workers voluntarily return this “gift”
to the firm by working in excess of the minimum standard. To the extent that gift
exchange behavior is present in labor markets, it is possible that wage and employment
policies could undermine, or enhance the benefits of gift exchange. If workers perceive
that high wages are the consequence of a generous employer they may be more likely to
work harder than if the wages are perceived to result from an external restriction or
incentive. If policies change employees’ perceptions of wages, then the potential impacts
on efficiency from different programs should be examined. Policies that encourage,
preserve, or capture the benefits from gift exchange behavior may be preferred in terms
of social efficiency to those that discourage such actions.

This dissertation focuses on two examples of policies that alter relative wages and
thus may change worker perceptions. Minimum wages and employment subsidies are
intended to increase the relative wages earned by low wage workers. Minimum wages
achieve this by requiring that all wage offers be above a certain level. Employment
subsidies achieve this by providing incentives for employers to hire workers from
targeted groups. Since employment subsidies do not suffer from the increased
unemployment associated with minimum wages they are considered by many to be a
superior policy in terms of labor market efficiency.

The implementation of these policies may however, have different consequences
in markets with gift exchange. To illustrate the effects of worker perceptions, consider
the minimum wage as an example. Minimum wages set a wage floor that could impact
employee effort. Imagine a worker who is earning $0.50 more than the minimum wage.
The worker may attribute this wage premium to the generosity of his/her employer and
thus provide “extra” effort as suggested by the theory of gift exchange. If the minimum
wage increases by $0.50, and the worker continues to receive the same wage, the worker no longer earns a premium. The worker now earns the lowest wage relative to the new distribution, and may stop providing extra effort as a result. However, workers earning wages well above the minimum wage may not reduce their effort since they are still earning higher wages relative to others. If their wages increase further as a result of the minimum wage increase, these workers may even increase their effort in response to this increase in wage. This possibility has not received much attention in the literature and is the focus of Chapter 2.

Employment subsidies are another policy tool that may have a different behavioral impact. Workers may be aware that employers receive external benefits for hiring certain workers. As a result these employees might attribute high wage offers to these incentives rather than to employer generosity even if they are receiving high wages relative to others. In addition, the workers who are employed without the subsidy may decrease their effort if they perceive a decrease in the gift they are being offered. If this is the case, subsidies may reduce the benefits resulting from reciprocity. This negative impact might be more pronounced with subsidies than minimum wages since employers do not receive external incentives with minimum wages. The impact of employment subsidies in markets involving gift exchange is the focus of Chapter 3.

Minimum wages and wage subsidies both have the goal of increasing the wages of low wage workers. This dissertation examines the effects of these policies in labor markets characterized by gift exchange behavior. The remainder of this chapter will provide a background of the literature relating to gift exchange, reference point effects, and also provides a brief review of minimum wage and subsidy studies. Chapter 2
examines the effects of minimum wages in experimental labor markets with gift exchange. Chapter 3 will examine the effects of employment subsidies into experimental labor markets with gift exchange. Chapter 4 summarizes the findings and concludes.

1.2 LITERATURE REVIEW

This section provides a review of the literature related to gift exchange, causal attributions of wages, reference points, minimum wage policy, and employment subsidies.

1.2.1 Gift Exchange

Several studies have examined “gift exchange” as a potential motivation for efficiency wages. Akerlof (1982) first modeled labor contracts as an exchange of gifts between a worker and an employer. In this model firms voluntarily offer the “gift” of a high wage to workers in order to affect workplace norms and increase worker effort. The workers in return voluntarily provide a “gift” to the firm by working in excess of the minimum standard. This form of efficiency wage is differs from other explanations for offering an efficiency wage, such to prevent shirking, because greater effort is provided voluntarily rather than as a result of the threat of job loss.

Support for the notion of gift exchange has been observed in the field studies by Campbell & Kamlani (1997) and Bewley (1999). These surveys indicate that employers carefully consider the effects that wages have on employee effort and are concerned that wage cuts will hurt worker morale and productivity. This concern causes firms to be reluctant to cut wages during a recession and provides an explanation for wage rigidity that is persistently observed.
Although field surveys can capture general perceptions about worker effort, it is nearly impossible to gather detailed data relating directly to employee effort. In order to study this concept directly, Fehr, Kirchsteiger and Reidl (1993) conducted a controlled laboratory experiment to test the Akerlof (1982) gift exchange model as a sequential prisoner’s dilemma. In this experiment the employers first make a wage offer. When an offer is accepted by an employee, the employee then chooses an effort level and the choice is revealed to the employer and the period ends. Employers are not able to change their offers. The payoffs are designed so that greater effort is costly to the worker and a higher wage is costly to the employer.

In the absence of other regarding preferences, the dominant strategy for workers is to always provide minimum effort because any other choice reduces their profits. Anticipating this, managers maximize their profits by offering the lowest possible wage. This seminal gift exchange experiment was conducted using an oral auction procedure for employees to make wages offers in a market with an excess supply of labor. Evidence of gift exchange emerges in this experiment with both managers and employees offering more than is predicted in absence of other regarding preferences. This preference for fairness prevented market wages from decreasing to their market clearing level.

An abundance of studies have used the paradigm of the gift exchange experiment and the main result that effort increases with wage has been replicated by many others. Some examples of gift exchange experiments are Fehr, Gachter and Kirchsteiger (1997) which shows that when both sides of the market can make reciprocal responses that enforcement of contracts is very strong relative to the case when only one side of the market can respond. They conclude that reciprocal motivations are important
considerations in the design of optimal incentive contracts. Fehr, Kirchler, Weichbold, and Gächter (1998) show that when bilateral bargaining is replaced by competition and excess supply is introduced, reciprocity does not decrease even though the competitive environment would tend to discourage it. Fehr and Falk (1999) conduct sessions using a double auction bidding procedure in situations with complete and incomplete contracts. They conclude that reciprocity is especially important in the absence of complete contracts. Charness, Frechette, and Kagel (2001) compare sessions conducted using a payoff matrix versus those using payoff functions and find that reciprocity is significantly lower in sessions where a table is used. Hannan, Kagel and Moser (2002) report that employee behavior is not influenced by the productivity of the firm. The effort responses made to high productivity firms are the similar to those made to low productivity firms. They also find that undergraduate students provide less effort than MBA students in these experiments. Fehr and Falk (2002) provide a review of much of the early gift exchange literature.

Brown, Falk, and Fehr (2004) extend the experiment to allow for the possibility of repeated interactions between workers and firms. They find that effort is greater in when repeated interactions are possible and that the threat of terminating the relationship is a powerful enforcement device. Brandts and Charness (2004) consider differences when the market has an excess supply of firms versus an excess supply of labor. They also include a minimum wage in the treatment with an excess supply of labor and find that effort is significantly decreased in the presence of a minimum wage using a between group design. Another study by Gneezy and List (2006) finds similar initial effects for
subjects who are required to do actual work as opposed to simply choosing a number that is costly. However, they find that the effects of gift exchange decline after a few hours in a field experiment involving actual work in a library.

These studies differ in terms of payoff functions, effort enforcement mechanisms, and presence of exogenous market conditions. However, they consistently show that participants are willing to forgo monetary rewards in order to reward generosity shown to them by another.

1.2.2 Causal Attribution

Another set of experimental studies indicates that behavior is sensitive to causal attributions regarding the basis for an action. In other words, the motivation behind the offer appears to influence decisions. For example, Blount (1995) reports that subjects playing an ultimatum game accepted significantly smaller offers when a roulette wheel randomly chose how to split the money rather than another person whose payoff depended on acceptance of the offer. In a gift exchange experiment Charness (2004) finds that employees responded with lower effort to low wages when they originated from a self-interested party whose payoff depended on their choice compared to when a low wage originated from a random source.

Several theoretical models have been proposed to explain this sort of behavior in economic situations where other regarding preferences appear to be important. Bolton and Ockenfels (2000) and Fehr and Schmidt (1999) for example present models where agents incorporate inequality aversion into their utility calculations. Individuals in laboratory experiments often act as if they prefer more equal distributions of payoffs and most actions can be explained by considerations for equity, reciprocity, and or
competition. However, these models do not account for the intentions of the agents. Falk and Fischbacher (2000) present a formal theory of reciprocity where the kindness of an action depends not only on the outcome, but also on the intentions of an action. This reconciles many experimental results. Benjamin (2005) proposes a model where the payoffs for the employee and the firm enter the employee’s utility function as perfect complements and, in addition, decisions are evaluated in relation to a fairness reference point. These models among others, have attempted to incorporate the concept of fairness in market situations.

1.2.3 Reference Points

The importance of reference points on decision making has started to receive more attention in the economics literature. The notion that within broad limits humans focus less on the absolute value of a stimulus than to deviations from established norms has been well documented in the psychological literature for some time (see, for example, Helson, 1964). The work of Kahneman and Tversky (1979) established the relevance of this insight to decision theory and economics. A study of money illusion reported in Shafir, Diamond and Tversky (1997) indicates for example, that a majority of respondents say they would be happier with a 2% rise in salary in times of 4% inflation than a 2% cut in salary in times of no inflation. Shafir et al. note that these results are entirely consistent with research in cognitive psychology showing that the reliance on a particular frame is typically guided by what is more salient, simpler, or more natural, not by strategic consideration. They go on to note that it is not unusual for people to employ multiple representations contemporaneously. In these cases the response is often a mixture of the assessments induced by the different representations, each weighted by its
relative salience. Frank (1989) describes the importance of context in predictions of human behavior. He claims that policy makers need to be aware of context in a way that is not captured by standard neoclassical models where utility is a function only of consumption. Clark (1999) finds evidence of these effects using micro data from British workers. The study finds that job satisfaction is positively related to increases in pay rates relative to past pay, but is unrelated to the current pay rate. Koszegi and Rabin (2006) present a theoretical model where preferences are reference-dependent. In their model the reference point is endogenously determined by expectations formed from previous wages.

1.2.4 Minimum Wages

The theoretical analysis of minimum wages in perfectly competitive markets clearly indicates that unemployment will increase with the introduction of a binding minimum wage. However, there is some controversy about the true effect in empirical studies of actual labor markets. Some studies find the opposite of the predicted effect. Card and Krueger (1994, 2000) do not find that an increase in the minimum wage reduced employment in a comparison of employment growth in fast food restaurants in New Jersey and Pennsylvania. Katz and Krueger (1992) find that employment increased in fast-food restaurants in Texas that were affected by an increase in the minimum wage. Other studies look at the distributional consequences of the minimum wage. Swidinsky and Wilton (1982) use Canadian minimum wage data and find that minimum wages tend to alter relative wages with limited “spillover” into the higher wage market. They argue that in the long run minimum wages will likely narrow the wage distribution. Neumark, Schweitzer, and Wascher (2004) find empirically that the effects of a minimum wage on
relative wages are different for different parts of the wage distribution. Those earning near the minimum wage see increases in income, but reductions in hours and employment make them worse off. Those that earn significantly more than the minimum wage see little effect. Metcalf (2004) uses British wage data to empirically estimate changes in the wage distribution resulting from the growth in average earnings. He finds that the bottom decile of the wage distribution received pay increases, however, no spillover to other parts of the distribution are found.

Falk, Fehr, and Zehnder (2005) study labor supply effects from minimum wages in an ultimatum game experiment. They find that the reservation wage demands for workers increase in the presence of a minimum wage. They also find that removal of the minimum wage does not return the reservation wage to its pre-minimum wage levels.

1.2.5 Employment Subsidies

There is a large body of work relating to subsidies to encourage employment. Some authors argue that subsidies are in theory a useful policy tool. Most notable among this work is Phelps (1997), which describes many positive social impacts from wage subsidies. Johansen and Strom (2001) present an efficiency wage model where relative wages matter to workers. They find that a tax based income policy of payroll taxes and employment subsidies can reduce equilibrium unemployment in a general equilibrium model. Orszag and Snower (2003) examine the effects of two types of subsidies intended to reduce unemployment and working poverty. They find that hiring subsidies that are targeted to the unemployed are more efficient at reducing poverty when earnings rise with job duration, and that wage subsidies granted to all low-wage workers are more efficient when earnings remain relatively flat over time.
However, others have differing views on the effectiveness of subsidies. Prasch (2002) examines the assumptions behind the support for wage subsidy theories and claims that wage subsidies will not be effective since these assumptions are unlikely to hold in labor markets. Empirical studies have not found much support in favor of subsidy programs. For example, Hollenbeck and Willke (1991) use data from the Unemployment Insurance system and the Employment Service Automated Reporting System to investigate the effects of the Targeted Jobs Tax Credit (TJTC) program. They conclude that the program helps young non-white males, but may be stigmatizing to other groups. In general, the workers who receive the subsidies receive higher wages, but this may be due to selection effects. Another study of the TJTC by Bishop and Montgomery (1993) suggests that about 70% of the subsidized employees who are hired would have found jobs even if they were not subsidized. Burtless (1985) examines a controlled social experiment with vouchers for wage subsidies and observes that employers view the subsidy as a signal of productivity, and the stigma associated with the subsidy may make the firm less likely to hire a subsidized worker. In addition, the study finds that few of the eligible workers take advantage of these programs and that only 25% of the employers who hired eligible employees registered to receive the subsidies. Burtless (2000) summarizes several findings and concludes that basic job skills training programs are more effective and less costly than targeted subsidies which are largely ineffective and underutilized. Michalopoulos, Robins, and Card (2005) find that targeted subsidies in the form of negative income taxes paid for themselves with reductions in welfare payments in one social experiment, but not in another. They also observe low participation rates in both groups.
1.2.6 Summary

In summary, these different bodies of work indicate the following tendencies. First, the gift exchange explanation of efficiency wages emerges consistently in laboratory experiments and employer surveys where wages seem to influence effort provision. Second, in many situations people have been observed to focus on changes in wages relative to a reference point rather than on the absolute value of the wage. Third, there is some uncertainty about the actual effect of minimum wages that has yet to be fully explained. Fourth, it is argued that subsidies may have desirable consequences in theory that have yet to be supported empirically. The combination of these tendencies combines to form the motivation for laboratory experiments.
CHAPTER 2

MINIMUM WAGE RESTRICTIONS AND EMPLOYEE EFFORT IN LABOR MARKETS WITH GIFT EXCHANGE PRESENT\(^1\)

ABSTRACT

Minimum wage restrictions are introduced into an experimental labor market characterized by gift exchange between employers and employees. Experiment 1 shows that introducing a minimum wage into an ongoing labor market has an overall positive effect on employee effort as there is a small, statistically insignificant, negative effect on effort at low wages, and a larger, statistically significant, positive effect at higher wages. However, in comparing a labor market that starts with a minimum wage versus one that does not, the minimum wage results in sharply reduced effort. (i) These differences in results are entirely consistent with the decision theoretic research on reference point effects and (ii) the response to the minimum wage within an ongoing labor market has greater “ecological validity” for evaluating the likely impact outside the lab. Experiment 2, using payoff functions that make gift exchange more costly to both employers and employees, confirms that the effects of a minimum wage on effort within an ongoing labor market are unlikely to have a major adverse effect on employee effort.

\(^1\) This chapter closely follows Owens and Kagel (2006).
2.1 INTRODUCTION

Issues surrounding the minimum wage have a long history both in economic theory and in practice. Every few years there are calls for increasing the minimum wage and there is debate about the merits and the problems associated with minimum wages. The standard economic argument against the minimum wage is that in a perfectly competitive labor market imposing a minimum wage that exceeds the market determined equilibrium wage will lead to increased unemployment.\(^2\)

In contrast there has been very little analysis of the potential incentive effects of minimum wages on workers. Incentive effects of minimum wages are, of course, irrelevant within standard economic theory. However, in markets characterized by efficiency wages, in particular efficiency wages guided by gift exchange considerations (Akerlof, 1982), the introduction of a minimum wage might reduce worker effort as a result of workers discounting the gift component of the wage payment by the amount of the minimum wage requirement.\(^3\) If workers’ effort levels are in fact reduced in response to a minimum wage, then this change in behavior is another potential source of inefficiency resulting from minimum wages. However, as we will see, it is also possible for a minimum wage requirement to increase worker effort if workers respond favorably to an increase in wage relative to the past.

It is extremely difficult to measure effort in field settings; much less the effects that increases in the minimum wage have on worker effort. However, with the successful

\(^2\) Empirical studies regarding the employment effect of increases in the minimum wage have been subject to some controversy recently. Katz and Krueger (1992) and Card and Krueger (1994), do not find that unemployment increases with minimum wage increases. In contrast, Neumark, Schweitzer, and Wascher (2004) find that work hours are reduced.

\(^3\) In the Akerlof (1982) model firms voluntarily offer a “gift” to workers in the form of a wage that is above the zero unemployment market clearing wage. In return workers voluntarily provide a “gift” to the firm by working in excess of the minimum standard.
development of a paradigm for studying gift exchange in experimental labor markets (see, for example, Fehr, Kirchsteiger, and Riedl, 1993), one can gain insight into the possible incentive effects of minimum wages through laboratory experiments. This chapter does this, reporting results from a series of laboratory markets both with and without minimum wages.

To date only Brandts and Charness (2004) have looked at the relationship between minimum wages and effort in a gift exchange experiment. Their experiment compares one group of subjects facing a minimum wage to begin with versus another group that does not (a “between group” design). They find that effort is reduced significantly when a minimum wage is present.

The present paper studies the effects of introducing a minimum wage within an ongoing labor market (a “within group” design). We do so because (i) from the decision theoretic research it is clear that reference points matter, so that the reaction to a minimum wage within a given labor market is likely to be quite different from the comparison between two different labor markets and (ii) we believe that a within group design is of greater ecological validity as minimum wages, or increases in minimum wages, are commonly introduced into ongoing labor markets. That is, comparing a market that has always had a minimum wage to one that does not cannot, by definition, capture changes in employees’ perceptions resulting from changes in wage offers that the

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4 The identification of gift exchange effects is not limited to experimental labor markets. For example, Campbell and Kamlani (1997) and Bewley (1999) find support for the presence of gift exchange in labor markets from employer surveys.

5 Aside from Brandts and Charness (2004), no previous experimental studies of gift exchange have looked at the effect of minimum wages on employee effort (which is just one of several treatments in the Brandts and Charness experiment). Other experimental studies relating to minimum wages such as Falk, Fehr, and Zehnder (2006) have focused on labor supply effects and reservation wage demands, but have not considered changes in effort levels.
introduction of a minimum wage might produce. Introducing a minimum wage into an ongoing labor market directly captures the impact of any changes in employees’ perceptions on effort responses.

In the first experiment we find that the introduction of a minimum wage into an ongoing labor market has an overall positive effect on employee effort. There is a small, statistically insignificant, negative effect on effort at low wages, and a larger, statistically significant, positive effect on effort at higher wages, as well as a sharp increase in the frequency of high end wages. Further, even after eliminating the minimum wage these higher average wages and effort levels are sustained, generating a Pareto improving outcome relative to the initial no minimum wage treatment. However, using the same payoff functions and the same subject pool, comparing a labor market that starts with a minimum wage versus one that does not, shows that effort is sharply reduced with the minimum wage. In fact, by and large the minimum wage group acts as if the minimum serves as the zero wage reference point, providing strikingly similar effort levels to the no minimum group for all wage levels after adjusting for the minimum to be the zero wage point. We relate these different results to the decision theoretic research showing similar reference point effects.

We also report results from a second experiment, which introduces a minimum wage into an ongoing labor market employing payoff functions similar to those employed in Brandts and Charness (2004). These payoff functions serve to raise the cost of reciprocating a gift considerably for both employers and employees relative to Experiment 1. Under these payoff functions the minimum wage produces a substantially smaller increase in average wages compared to Experiment 1. Further, the pattern of
employee effort is similar to Experiment 1, only the reduction in effort at lower wages is larger and the increase in effort at higher wages is smaller. Nevertheless we are unable to reject a null hypothesis that in this case the minimum wage has no effect on worker effort.

This Chapter is organized as follows. Section 2.2 describes some testable hypotheses. Section 2.3 describes the design and results for Experiment 1. Section 2.4 presents the design and results for Experiment 2. Section 2.5 summarizes our results and adds some concluding remarks concerning the limitations of the results for behavior outside the lab. Appendix A contains figures, Appendix B contains statistical results, and Appendix C contains the experimental materials and instructions.

2.2 HYPOTHESES

Minimum wages could have a positive or negative impact on employee effort in a gift exchange paradigm for a number of reasons. The key factor potentially producing a negative effect is that behavior is sensitive to causal attributions regarding the basis for an action as shown in past experiments. For example, Blount (1995) reports that subjects playing an ultimatum game accepted significantly smaller offers when a roulette wheel randomly chose how to split the money rather than another person whose payoff depended on acceptance of the offer. In a gift exchange experiment Charness (2004) found that employees responded with lower effort to low wages when they originated from a self-interested party whose payoff depended on their choice compared to when a low wage originated from a random source. Thus, to the extent that employees view higher wages as less of a gift in the presence of a minimum wage requirement that is
clearly outside the employers’ control, they might be expected to provide lower effort for any given wage rate. Further, if employers fail to increase wages except as required under the minimum wage (i.e., they only increase wages for those workers that had received below minimum wages in the past), this might tend to exacerbate any potential causal attribution effects.

On the other hand, there are reasons to think that the introduction of a minimum wage might have no effect on worker effort, or possibly increase effort. If employees only care about the absolute amount of money that they are given – “money is money” - the minimum wage will have no effect on effort. Similarly, if workers recognize that any wage above the minimum represents as much of a gift on the part of the firm as before the minimum, the minimum wage should have no impact on worker effort.  

Further, to the extent that workers tend, in general, to respond to higher wages with greater effort (which is the basis for gift exchange in the first place), and they use wages received prior to the minimum wage requirement as their reference point, increases in wages resulting from the minimum wage might well result in increased effort. Managers who were making wage offers below the new minimum wage must increase their offers, and in addition some managers already offering above minimum wages may increase their offers in order to maintain a wage premium to generate greater effort. If the frequency of high wage offers increases, many employees will receive

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6 In this respect it is worthwhile noting that in Charness (2004) higher wage offers were met with similar effort regardless of whether they originated from a self-interested party whose payoff depended on the workers’ choices or from a random source.

7 Another possibility is that if the increase in the minimum wage results in increased unemployment, those still holding jobs may provide more effort in response to the increased excess supply of labor. Our experimental design severely limits the scope for such an effect.
higher wages relative to before. The psychological literature suggests that employees may respond favorably to this positive change in earnings relative to the past, and thus increase their effort.

2.3 EXPERIMENT 1

2.3.1 Experimental Design:  
In each session, subjects were divided into two groups with ten subjects in each group. (The one exception is session 3, which was conducted with two groups of eight participants due to low participant turnout.) One group was randomly chosen to be “managers” and the other group was chosen to be “employees” for the entire session. In all periods each manager was paired anonymously with exactly one employee. The pairings were reassigned randomly before each market period. In sessions with more than ten market periods, and in the one session with fewer than ten pairs, each employee was matched with each manager no more than twice and never re-matched in two consecutive periods. Details regarding the random assignment of pairings were explained before the start of each session and were repeated before each of the first several market periods within each session. Each participant was given a written copy of the instructions, which were read aloud to all participants.

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8 The experimental procedures employed are an extension of those developed by Ernst Fehr and his colleagues to study gift exchange in labor markets (see, for example, Fehr, Kirchsteiger, and Riedl, 1993 and 1998). The experiment was conducted with pencil and paper. Instructions are posted in Appendix C.

9 The terms “manager,” “employer,” and “firm,” and “employee” and “worker” are used interchangeably.

10 The method of pairings managers and employees is the same as in Charness, Frechette and Kagel (2004).

11 These procedures are intended to create a series of one-shot games so that the only motivation for offering efficiency wages is the potential gain from higher effort. Models of efficiency wages as a means to prevent shirking, or to establish a reputation, are not applicable here.
In each period managers were asked to choose a wage for an employee. Each employee was then given the individual wage that was offered to him/her. Wage offers were written directly on employee record sheets so that only the manager and employee involved in the contract knew the wage offer. After receiving the wage, each employee was asked to choose an effort level, which was transmitted back to the manager in question.\textsuperscript{12} Thus, both wage offers and effort levels were private information for the manager and worker in each pairing.

The firm’s payoff function and employee’s effort-cost relationship were provided to both managers and employees so that this information was common knowledge. Participants were provided with calculators and were required to compute, correctly, the payoffs for both managers and employees in several examples prior to the start of the experiment.

The payoff functions for managers ($\Pi_M$) and employees ($\Pi_E$) were

\begin{align*}
\Pi_M &= (100 - w) \times 0.2 + 8e \\
\Pi_E &= w - c(e)
\end{align*}

where $w$ is the wage rate, $e$ is the employee effort level and $c(e)$ is taken from the following table:

<table>
<thead>
<tr>
<th>Effort</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
<th>10</th>
</tr>
</thead>
<tbody>
<tr>
<td>$c(e)$</td>
<td>0</td>
<td>1</td>
<td>2</td>
<td>4</td>
<td>6</td>
<td>8</td>
<td>10</td>
<td>13</td>
<td>16</td>
<td>20</td>
</tr>
</tbody>
</table>

\textsuperscript{12} The term “effort” is used throughout this paper but in the experiment “Amount of Work” was used in its place.
The payoff function for employees, along with the effort cost schedule, is taken directly from prior gift exchange experiments (see, for example, Fehr, Kirchsteiger and Riedl, 1998). The payoff function for managers is modified relative to previous work. One popular specification of manager profits in past experiments is $\Pi_M = (100 - w) \times e$. In this case the marginal benefit for any given effort level depends on the wage offered. Using this function, a manager receives smaller marginal benefits under a minimum wage requirement unless effort increases proportionately. This would tend to inhibit managers from raising wages above the minimum requirement. The fact that the manager’s profit function is linear holds the marginal costs and benefits constant for any given effort level. The 0.2 multiplier used in the manager’s payoff function, in effect, reduces the cost of raising wages. In this way we hoped to see how employees would respond at higher wages following the introduction of the minimum wage. The Nash equilibrium in the absence of any gift exchange motives has employees providing the minimum allowable effort and managers, anticipating this, offering the lowest possible wage. Managers were given 100 “offer notes” in each market period to pay wages, so that the maximum possible wage is 100.

Experiment 1 employed four sessions to look at the effects of introducing (and eliminating) minimum wages both within an ongoing labor market and between labor markets. Sessions 1 and 2 look at the effect of introducing and eliminating minimum wages within an ongoing labor market. Both sessions had fifteen market periods and used an ABA design: no minimum wage in periods 1-5, a minimum wage in periods 6-10, and

13 Since the goal is to study the effects of minimum wage restrictions in a labor market that contains gift exchange, it is critically important that gift exchange behavior remains under the minimum wage. Using multiplicative payoffs we could not separate the effect of a reduction in marginal benefits to managers from offering a higher wage from the direct effect that the minimum wage has on worker effort.
the minimum wage was dropped in periods 11-15. Sessions 3 and 4 served primarily to compare the effects of a market that starts with a minimum wage to one that has no minimum as periods 1-5 began with the same minimum wage as used in sessions 1 and 2. Thus, comparing wages and effort levels between periods 1-5 in sessions 1 and 2 with sessions 3 and 4 allows us to look at the “between groups” effect of a minimum wage. Periods 6-10 in sessions 3 and 4 dropped the minimum wage giving us another look at the impact of eliminating the minimum wage in an ongoing labor market; albeit one with a different prior history. In each case the subjects knew the number of periods but had no prior notice that the minimum wage condition would change. The minimum wage was set at 40 in all sessions. It was determined from the data in session 1 so that the minimum wage would have impacted 25-30% of all wage offers in periods 1-5, thereby creating a significant minimum wage effect while still providing ample scope to examine the impact of the minimum wage on higher wage earners.

Subjects were paid privately and individually at the end of each session at a rate of 25 experimental dollars to 1 US dollar along with a $5 participation fee. Average earnings for sessions 1 and 2 were approximately $42.00 for employees and $34.50 for managers, and $25.10 and $18.30, respectively, in sessions 3 and 4. Sessions 1 and 2 lasted about one hour and forty-five minutes with sessions 3 and 4 lasting about one hour and fifteen minutes.

2.3.2 Experimental Results:

Results from Experiment 1 are presented in three parts. First, we report the effects of introducing the minimum wage within sessions 1 and 2. Second, we examine the between group effects of the minimum wage comparing the initial no minimum wage
periods from sessions 1 and 2 with the initial minimum wage periods of sessions 3 and 4. Third, we briefly report the effects of dropping the minimum wage, as this treatment is secondary to our main interest.

2.3.2.1. Effect of Introducing a Minimum Wage within an Ongoing Labor Market:

Figure 1 in Appendix B shows average wages and effort over time before and with a minimum wage equal to 40 in sessions 1 and 2. As in previous gift exchange experiments, wages and effort are significantly different from the minimum levels predicted by the Nash equilibrium (absent any gift exchange motives). The introduction of the minimum wage resulted in a marked increase in average wages from 59.1 before the minimum to 75.7 with the minimum. Note that the minimum wage served to raise wages for workers who were not “covered” by it, and/or raised wages for those covered by more than the minimum requirement as average wages in periods 1-5 would only have increased to 64.4 if all workers with below minimum wages had instead received the minimum. This increase in average wages was accompanied by an increase in the average effort level from 4.43 to 5.94. Figure 2 presents the results of kernel regressions relating wages to effort before and after introducing the minimum wage in sessions 1 and 2. The kernel regressions provide a pictorial representation of the impact of wages on effort before and after the minimum wage at all wage levels. Essentially they “smooth” the relationship between wages and effort without imposing a functional form on the relationship.\textsuperscript{14}

The kernel regressions show that in the neighborhood of the minimum wage, effort is greater than what it was at the lowest wage rates prior to introducing the

\textsuperscript{14} They smooth the data by essentially taking local weighted averages of both the independent and dependent variables when estimating the regression function.
minimum, but somewhat below what it was at the same wage rates without the minimum. That is, the minimum wage serves to reduce effort a bit at low wages compared to before the minimum, but effort does not fall completely to the effort levels associated with the very lowest wages prior to the minimum wage. This reduction in effort gets smaller and smaller at higher wages so that at approximately a wage rate of 55, effort matches what it was prior to the minimum, and remains there, or is slightly higher than before the minimum, up to wage rate 80. At that point effort with the minimum wage starts to exceed what it was prior to the minimum, with this difference getting larger and larger at higher wage rates. Regressions reported in Tables 1 through 3 of Appendix B indicate that the modest negative effect of the minimum wage on effort below wage 55 is not statistically significant at conventional levels, while the larger positive effect on effort at higher wages is significant.\textsuperscript{15} In short, the introduction of the minimum wage has a modest negative effect on effort compared to before the minimum for wages near the minimum, and a stronger positive effect on effort at higher wage rates. As such it is clear that workers do not simply treat wages at or near the minimum as a zero wage gift, nor do they subtract out the minimum wage requirement in calibrating their response to higher wages. We return to what we believe drives these results momentarily.

What accounts for the increase in effort under the minimum wage relative to before, at the high end of the wage scale? First, note that there is a large increase in the relative frequency of high end wages with the minimum compared to before it as shown in Figure 3. Prior to the minimum wage, 40% of all wage offers were at 71 or above.

\textsuperscript{15} Statistical tests using the kernel regressions are sensitive to the band width over which averaging is done and cannot account for the autocorrelation in effort levels associated with repeated measures for the same worker at different wage rates. The tradeoff is that the Tobits restrict the functional form of the relationship between wages and effort.
versus 60% with the minimum, with much of this difference driven by wage offers of 91-100 (16% before versus 30% with the minimum). Table 4 in Appendix B also characterizes a clear shift in the wage offers in the presence of the minimum wage, but also shows the movement by individual managers offering in each range. For example, the first row of data shows that of the 28 offers made by managers in the range less than 40 in the periods before the minimum wage, 17 (60.7%) of these shifted to between 40-60, 8 (28.6%) shifted to between 61-80, and 3 (10.7%) shifted to wages greater than 80 in the minimum wage periods. The increase in wages was not limited to managers who made low offers, rather all managers tend to offer wages in the same or higher range. Introducing a minimum wage into this ongoing market clearly shifts the wage distribution to higher levels.

Further, as the regression results in Table 5 show, employees respond to wages that are higher than any past wage they have seen with greater effort, so that the increase in the high end wages that goes along with the minimum wage produces greater effort. That is, employees act as if past wages serve as a reference point against which to judge the generosity of the gift provided, responding with greater effort to the increase in wages that the minimum wage triggered. This use of past wages as a reference point against which to judge the value of the gift inherent in higher wages, as opposed to the absolute value of the wage relative to the lowest level it could be, is fully consistent with results from the decision theoretic literature (see, for example, Kahneman and Tversky, 1979; Shafir, Diamond, Tversky, 1997; Helson, 1964). But this is only part of the story as there are opposing forces at work near the minimum wage. We return to this part of the story after reporting the between group effects of a minimum wage in the next section.
2.3.2.2 Between Group Effects of a Minimum Wage:

Evaluating the effects of a minimum wage through comparing an ongoing labor market that has no minimum wage versus an otherwise identical market that has always had a minimum wage yields results that are quite different from those reported in the previous section. Figure 4 compares average wages and effort in the first five periods of sessions 1 and 2, periods without a minimum wage, with the first five periods of sessions 3 and 4 that start with a minimum wage of 40. Average wages are roughly the same between the two markets (59.1 with no minimum versus 63.1 with it), but average effort is substantially lower in the market that starts with the minimum wage (2.92 versus 4.43). The kernel regression estimates reported in Figure 5 show that evaluating the impact of the minimum wage on effort levels through this kind of between group comparison yields (i) lower effort at all wages in the market that starts with the minimum wage of 40 and (ii) these reductions in effort are quite substantial and are the same or larger at all wages rates compared to the reductions in effort found for the minimum wage reported in Figure 2 in the previous section. Further, as the random effects Tobit estimates reported in Table 6 and the random effects ordered probit estimates reported in Tables 7 and 8 of Appendix B show, there is significantly less effort provided under the minimum wage treatment at all but the very highest wage rates in this case, contrary to the results reported in the previous section.

Figure 6 provides an even more revealing look at the impact of the minimum wage in this case. There we compare kernel estimates of the impact of wages on effort after having transposed wages in sessions 3 and 4 by subtracting 40 (the minimum wage) from all wage offers. Under this transformation, the minimum wage in sessions 3 and 4
matches the zero wage in sessions 1 and 2. At the very lowest wage rates there are minimal differences in effort levels between sessions 1 and 2 versus 3 and 4 under the transformed wages. Although effort levels are clearly higher under the minimum wage treatment around wage 20 (transformed wage 60), these differences appear to be idiosyncratic as they are completely eliminated by wage 40 (transformed wage 80). Differences reemerge at the highest wage rates with the maximum difference reported at wage rate 60 (transformed wage 100). Thus, at all but the highest wage rates, there are no consistent differences in effort levels for comparable (adjusted) wage rates. That is, the effort levels of employees in sessions 3 and 4 are quite similar to what they were in sessions 1 and 2 for comparable wages once the zero wage (zero gift) reference point is set equal to the minimum wage in 3 and 4. As a result the random effects Tobit estimates reported in Table 9 of Appendix B find no significant differences between effort levels under the two treatments when regressing on the transformed wage rates in sessions 3 and 4.

Figure 7 shows the difference in the relative frequency of wage offers by range for the first five periods of sessions 1 and 2 versus the first five periods in sessions 3 and 4 (with minimum wage). The wage distribution is initially somewhat similar. In this comparison, the market never responded to a change in the minimum wage, so a shift to higher wages was not observed and thus the minimum wage did not induce greater effort. Figure 8 shows the difference in frequency of wage offers in the minimum wage periods in sessions 1 and 2 versus the minimum wage periods in sessions 3 and 4. Again it is clear that the wage distribution shifted to higher wages in response to the minimum wage
in an ongoing market. This shift caused a change relative to prior wages in the ongoing market which is not present in the periods that begin with a minimum wage.

Clearly, these results for both effort and wages differ rather dramatically from the impact of introducing a minimum wage within an ongoing labor market as reported in the previous section. So, although the results of this section replicate, at least qualitatively, the results of the between group comparison of minimum wages on effort reported in Brandts and Charness (2004), the impact of introducing a minimum wage within an ongoing labor market yields quite different results.\footnote{There are some quantitative differences between our results and those of Brandts and Charness (2004). A figure corresponding to our Figure 5 would show significantly higher effort under the minimum wage for comparable wage rates beginning at the origin in Brandts and Charness (2004); e.g., the average effort at 0 wage is 0 versus 1.03 with the minimum wage. Further, Brandts and Charness find a sharp drop in the frequency with which the highest possible wage is offered with the minimum wage than without it, whereas these frequencies are essentially the same here (16% of all wage offers in the 91-100 wage interval in sessions 1 and 2 versus 13.3% in sessions 3 and 4).} Further, we would argue that it is the latter that has greater ecological validity for extrapolating to labor markets outside the laboratory as minimum wages are introduced, or increased, within ongoing labor markets.

The difference in results between this section and the previous section clearly illustrates the importance of accounting for reference point effects in evaluating the impact of introducing a minimum wage, and is entirely consistent with results reported from the decision theoretic literature. The notion that within broad limits humans focus less on the absolute value of a stimulus than to deviations from established norms has been well documented in the psychological literature for some time (see, for example, Helson, 1964). The work of Kahneman and Tversky (1979) established the relevance of this insight to decision theory and economics. As applied here, from a strictly rational point of view any wage greater than 40 represents just as much of a gift from the firm’s...
point of view regardless of whether or not there is a minimum wage of 40 in place.

However, for employees whose initial/only reference point is 40, a wage of say 50 or 55 does not appear to be much of a gift at all.

In contrast, in sessions 1 and 2 workers form their initial beliefs about the gift associated with a given wage based on a reference wage of zero. The response to the change in wages resulting from the introduction of the minimum wage of 40 is evaluated relative to these established norms and expectations. And relative to these norms and expectations the increase in wages following the introduction of the minimum wage represents a larger gift on the part of the firm.\(^\text{17}\) As a result, in sessions 1 and 2 the introduction of the minimum wage generates two competing forces: The reference point for zero gift has been shifted from 0 to 40, but for many wages have increased (sometimes substantially) relative to the past. For wage offers near the minimum wage the reference point effect tends to win out as there is somewhat less effort provided. However, at higher wages the wage change effect dominates and there is an increase in effort. Our conjecture is that it is more natural for subjects to evaluate low wages relative to the lower bound and high wages relative the prior wages as they are more removed from the minimum wage lower bound.

These results are quite similar to those found in the study of money illusion reported in Shafir, Diamond and Tversky (1997). There, they report (for example) that a majority of respondents indicate that they would be happier with a 2% rise in salary in

\(^{17}\) Any “irrationality” of such an effect is no different than the well documented irrationality of workers responding to lower wages in a recession with less effort. In addition to documentation of such an effect (or fear of such an effect) in field settings (Campbell and Kamlani, 1997; Bewley, 1999) there is well documented laboratory evidence of this effect in an experimental labor market similar to the one employed here (Hannan, in press).
times of 4% inflation than a 2% cut in salary in times of no inflation. Shafir et al. note that these results are entirely consistent with research in cognitive psychology showing that the reliance on a particular frame is typically guided by what is more salient, simpler, or more natural, not by strategic consideration. They go on to note that it is not unusual for people to employ multiple representations contemporaneously. In these cases the response is often a mixture of the assessments induced by the different representations, each weighted by its relative salience, much like what appears to be going on at lower wages after the minimum wage is introduced in sessions 1 and 2.

2.3.2.3 Effects of Eliminating the Minimum Wage:

Figure 9 shows average wages and effort for the five periods after eliminating the minimum wage in sessions 1 and 2 (top panel) and in sessions 3 and 4 (bottom panel) compared to the previous five periods with the minimum wage. In sessions 1 and 2 there is essentially no impact on wages, and no impact on effort, in the periods after eliminating the minimum wage. Table 14 shows the movement of wages after the minimum wage is removed and Figure 3 shows the frequency of wage offers with and after the minimum wage. The removal of the minimum wage does not shift the wage distribution back to where it was in the before periods. Some of the managers that were offering low wages in the before periods do return to offering low wages in the after periods, but many of those offering wages from 41-80 in the before periods increased their offers with the minimum wage. These higher offers were met with greater effort and thus greater profits for the managers.

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18 Shafir et al. primarily employ data from questionnaires.
19 The latter is confirmed by the random effects Tobit reported in the first data column in Table 10 and the ordered probit reported in the first data column of Table 11 and Table 12 in Appendix B.
After receiving higher profits in the minimum wage periods, the managers saw the benefits of offering a higher wage and continued to do so even after the removal of the minimum wage.

Both managers and employees are better off in the last five periods after the minimum wage is dropped compared to before it was introduced: Manager profits averaged 43.6 per period prior to the minimum compared to 51.5 in the five periods after the minimum was eliminated; employee profits averaged 53.1 per period prior to the minimum compared to 65.5 in the five periods after the minimum was eliminated. That is, the minimum wage treatment served to induce a lasting, Pareto improving outcome after it was dropped.

The results are different in sessions 3 and 4. Eliminating the minimum wage in that case reduced average wages. However there is no significant impact on effort holding wages constant. That is, employees effectively adjusted the reference point for a zero wage gift back to a wage of zero following elimination of the minimum wage. Figure 10 shows the change in wage frequencies in these sessions. In these sessions managers who were offering low wages with the minimum wage were receiving low effort from the start. When given the opportunity to reduce their wage they did so because for given, low effort, they could increase their profits by cutting wages.

2.4 EXPERIMENT 2:

Experiment 2 introduces a minimum wage when effort is more costly. The payoff functions for managers and employees used in Experiment 1 differ substantially from

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20 See the second data column in Tables 10 and 11 and also Table 13 in Appendix B.
those employed in the between group study of the impact of minimum wages employed in Brandts and Charness (2004).21 Experiment 2 is designed to use payoff functions similar to those used by Brandts and Charness (2004) to determine the robustness of the effects of introducing a minimum wage within an ongoing labor market to the payoff functions employed.

2.4.1 Design of Experiment 2:

Experiment 2 employed exactly the same procedures as Experiment 1 with the exception of the profit functions for managers and employees. These were

\[ \Pi_M = 100 - w + 5e \]
\[ \Pi_E = 100 - e + 5w \]

with both wages and effort being chosen from the interval \([0,100]\). This is a rescaled version of the profit functions in Brandts and Charness (2004).22 As in Experiment 1 the Nash equilibrium in the absence of gift exchange motives is for managers to offer the lowest possible wage and for employees to provide the minimum allowable effort.

Relative to the payoff functions employed in Experiment 1 it is now more costly for firms

\[ \Pi_E = 10 - e + 5w \quad \Pi_M = 10 - w + 5e \]

with wages and effort chosen from the interval \([0,10]\) and the minimum wage set at 5 (as they did). Mean wages were 6.82 before the minimum wage and 7.34 with the minimum wage with mean effort levels of 4.10 and 4.26 with and without the minimum, respectively. Mean wages were comparable to those reported in Brandts and Charness (mean wage of 7.45 in the relevant no minimum treatment and 7.82 in the minimum wage treatment) and were substantially higher (accounting for the scale difference) than in our Experiment 1. These high initial (no minimum) wage levels inhibited any chance for a significant increase in wage as a result of the minimum wage given the upper bound on wages of 10, and thus inhibited an increase in effort since higher wages are the trigger for increased effort. Our guess was that high wages resulted from the scale \([0, 10]\) employed since, for example, a wage of 2 appears to be much smaller than a wage of 20. (As disturbing as such scale effects might be for economists, comparable scale effects have been documented in the decision theory literature; see, for example, Yamagishi, (1994a,b)). We rescaled the profit functions and the conversion rate by a factor of ten in an effort to establish comparable initial conditions to Experiment 1.

21 We were not aware of the Brandts and Charness (2004) experiment until after completing sessions 1 and 2 in Experiment 1.
22 We conducted one session with exactly the same profit functions as Brandts and Charness (2004): \( \Pi_E = 10 - e + 5w \) and \( \Pi_M = 10 - w + 5e \), with wages and effort chosen from the interval from \([0, 10]\) and the minimum wage set at 5 (as they did). Mean wages were 6.82 before the minimum wage and 7.34 with the minimum wage with mean effort levels of 4.10 and 4.26 with and without the minimum, respectively. Mean wages were comparable to those reported in Brandts and Charness (mean wage of 7.45 in the relevant no minimum treatment and 7.82 in the minimum wage treatment) and were substantially higher (accounting for the scale difference) than in our Experiment 1. These high initial (no minimum) wage levels inhibited any chance for a significant increase in wage as a result of the minimum wage given the upper bound on wages of 10, and thus inhibited an increase in effort since higher wages are the trigger for increased effort. Our guess was that high wages resulted from the scale \([0, 10]\) employed since, for example, a wage of 2 appears to be much smaller than a wage of 20. (As disturbing as such scale effects might be for economists, comparable scale effects have been documented in the decision theory literature; see, for example, Yamagishi, (1994a,b)). We rescaled the profit functions and the conversion rate by a factor of ten in an effort to establish comparable initial conditions to Experiment 1.
to pay workers at all positive wage rates, holding the anticipated effort level constant. In addition, both the marginal and absolute cost to workers of providing any given effort level is more costly (after rescaling) compared to Experiment 1.

Two sessions were conducted with ten periods each. The first five periods were conducted without a minimum wage; the last five with a minimum wage of 40. Participants were paid privately and individually at the rate of 250 experimental dollars to 1 US dollar, with average earnings for Experiment 2 approximately $20.00 for employees and $12.00 for managers. Sessions lasted about one hour and fifteen minutes.

2.4.2 Results for Experiment 2:

Figure 11 displays mean wages and effort by period for Experiment 2. Average wages increased modestly following the introduction of the minimum wage as did average effort. Figure 12 shows the kernel regressions relating wages and effort for Experiment 2. The pattern is similar to the one reported for the introduction of a minimum wage within an ongoing labor market in Experiment 1: Effort provided at the minimum wage is (i) well above the effort provided at the zero wage point before introducing the minimum, (ii) lower under the minimum wage than without it for low wages, and (iii) higher under the minimum than without it for higher wages. The primary difference from Experiment 1 is that the reduction in effort at low wages is more pronounced here, the greater effort at higher wages is less pronounced, and the crossover point from lower to higher effort occurs later (at higher wages) here. Based on the random effects Tobits reported in Table of 15 and the ordered probit reported in Tables 16 and 7 of Appendix B we are unable to reject a null hypothesis that the minimum wage treatment had a significant effect on effort here.
Comparing outcomes between Experiments 1 and 2 before the minimum wage is put into effect, wages are quite similar averaging 55.0 in Experiment 2 versus 59.1 in Experiment 1. However effort levels are considerably lower in Experiment 2 (25.0) compared to Experiment 1 (44.3 after rescaling). No doubt one reason for these lower effort levels is that both the marginal (and absolute) cost of increased effort is greater in Experiment 2. The upward shift in wage offers is also much smaller in Experiment 2 as shown in Figure 13 (compared to Figure 3) presumably as a result of the higher wage cost. Thus, Experiment 2 demonstrates two effects. First, the uniformly negative and statistically significant impact of minimum wages on effort reported in Brandts and Charness (2004) for a between groups design does not extend to our introducing a minimum wage into an ongoing labor market with a comparable underlying economic structure. To be sure, subject population differences or other differences in experimental design may account for this. However, given the results from Experiment 1, we strongly suspect that the primary factor underlying these differences has to do with our introducing the minimum wage into an ongoing labor market, which results in workers employing a different reference point than would be employed in a between group comparison. Second, the underlying economic structure (as represented by manager and employee profit functions) plays an important role in determining the likely effect of introducing a minimum wage, or increasing a minimum wage, on worker effort levels. We do not get the relatively large increase in effort levels at higher wages here that we got in Experiment 1, with its lower marginal and absolute cost of providing increased effort.
2.5 SUMMARY AND CONCLUSIONS

This paper examines the impact of minimum wages on employee effort in a labor market characterized by gift exchange between employers and employees (Akerlof, 1982). The introduction of a minimum wage in a labor market of this sort might have an adverse effect on employee effort if employees discount the size of the gift represented in the wage offer by the amount of the minimum wage requirement. If this happened, it would indicate an additional cost to minimum wage laws above and beyond their potential employment effects on low wage workers.

Our experiments yield a number of key results. First, evaluating the impact of introducing a minimum wage within an ongoing labor market, as opposed to evaluating its impact by comparing outcomes between markets with and without a minimum wage, is critical to the results reported. In comparing between labor markets in Experiment 1, workers who start out with a minimum wage act as if the minimum wage is effectively the zero wage (zero gift) reference point, responding with comparable effort levels to those reported in the no minimum wage market after subtracting out the minimum wage requirement at all but the highest wages. That is, in the labor market that starts with a minimum wage workers act as if the minimum wage is the zero wage (zero gift) reference point, while workers in the labor market with no minimum wage treat the zero wage as the zero gift reference point. As such the conclusion from this exercise is that minimum wages reduce effort substantially, adding to whatever inefficiencies result from reduced employment of workers. In contrast, introducing the same minimum wage into an ongoing labor market has a relatively small, statistically insignificant, negative impact on effort close to the minimum wage, but a positive, statistically significant impact on
effort at higher wage rates. The mechanism behind this result is that employees respond with greater effort to wages that are higher than they have experienced in the past, and the minimum wage requirement leads to substantial increases in the frequency of high end wage offers. That is, workers act as if past wages serve as the reference point against which to evaluate the level of gift provided in spite of the fact that the primary motivation for the increased wages is the minimum wage requirement. These quite different results clearly illustrate the importance of accounting for reference point effects in evaluating a change in economic policy of this sort, and are entirely consistent with results reported in the decision theoretic literature (Helson, 1964; Kahneman and Tversky, 1979; also see Shafir, Diamond, and Tversky, 1997).

Withdrawal of the minimum wage following its introduction in Experiment 1 maintains the new higher wage and effort levels associated with the minimum wage requirement. Thus, the minimum wage resulted in a new, Pareto improving, outcome for both firms and workers even after the minimum wage was dropped. Of course, these outcomes cannot be expected to occur universally as a consequence of introducing a minimum wage requirement into an ongoing labor market as witness the results from Experiment 2. However, even in Experiment 2, with more costly requirements for providing increased effort and increased wages compared to Experiment 1, the introduction of minimum wages into an ongoing labor market had no statistically significant, averse effect on employee effort.

The different treatments employed in Experiment 1 – evaluating the effects of a minimum wage between groups as opposed to the effect of introducing it into an existing labor market – corresponds to what experimenters refer to as a between group versus a
within group experimental design. Typically choosing between these two methods for evaluating outcomes has relatively benign effects on the conclusions reached. Further, typically for the general reader comparing outcomes from between versus within group designs involve the kind of esoteric issues that experimenters should hash out among themselves. However, they are important to evaluating the potential external validity of the experiment’s results in this case with, we would argue, the within group results having greater “ecological” validity. Further, the underlying basis for the different outcomes in this case rests on well established principles of reference point effects from the decision theoretic literature that economists need to be more sensitive to.

There is, however, one issue regarding external validity that has yet to be addressed. New workers entering a labor market with a long standing minimum wage requirement might be expected to treat the minimum wage in the same way that our between group subjects did since it is the lowest wage they are familiar with. One can imagine, however, two countervailing forces to such an effect. First, to the extent that effort norms have been established in the workplace, they should be impacted by the introduction of, or increase, in the minimum wage in a manner similar to the results reported here, and these norms would tend to guide new worker behavior (see, Akerlof (1982), for example). Second, to the extent that minimum wages increase from time to time we might expect to have the same effect on effort as the introduction of the minimum wage into ongoing labor markets reported here. If this is true, this would provide a strong case for consistent increases in minimum wages, at least to the point of keeping up with inflation. At any rate, the longer run effect of minimum wages on effort, and the impact on new workers, is an open research question that deserves attention.
CHAPTER 3:

EMPLOYMENT SUBSIDIES IN LABOR MARKETS WITH GIFT EXCHANGE

PRESENT

ABSTRACT

An employment subsidy is introduced into an experimental labor market characterized by gift exchange between employers and employees. Initially the market has substantial unemployment and significant levels of gift exchange. Then, an employment subsidy is introduced into the market to eliminate the unemployment. The results indicate that the responses of the subsidized workers do differ from the responses of the unsubsidized workers when the subsidy is introduced. However, there is some evidence that unsubsidized workers who are already employed reduce their effort when the subsidy is introduced. These results suggest that employee perceptions may affect outcomes when employment subsidies are introduced into labor markets with gift exchange.

3.1 INTRODUCTION

Employment subsidies have been proposed as a policy option for reducing unemployment for targeted groups. In the typical form, firms are given subsidies in the
form of tax incentives if they hire individuals from the target group. In theory, employment subsidies are more effective than other wage policies in helping low skilled workers, such as the minimum wage, which may have the undesirable effect of increasing unemployment for the very groups they are intended to help (see Phelps (1997) for example). Although a case can be made that employment subsidies are theoretically superior to other policies, they have not generally been successful in practice for promoting employment.  

There are several possible explanations for what is at the heart of the underperformance of employment subsidies. First, the workers who qualify for subsidies may in fact be less desirable employees having lower skills and abilities than the unsubsidized workers. As a result, being eligible for a subsidy may signal to a firm that an employee is not an ideal candidate for the job. Second, even if the workers who are eligible for the subsidy possess skills and abilities comparable to those who do not qualify for subsidies, there may be a stigma attached to the workers who qualify for them (see for example, Hollenbeck & Willke, 1991). This stigma may make it more difficult for qualified workers to find a job. In this case perceived worker productivity, rather than actual productivity, accounts for the underutilization of employment subsidies.

The focus of this paper is a third explanation relating to the workers’ perceptions of wages. Such considerations are generally not included in the economic models of subsidies. However, previous experimental studies have found that causal attributions of wages are important (see Blount, 1995) and they may influence market outcomes. If the

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23 For example, a study of the Targeted Jobs Tax Credit by Bishop and Montgomery (1993) suggests that about 70% of the subsidized employees who are hired would have found jobs even if they were not subsidized. Burtless (1985) conducts a controlled field experiment and finds that some employers did not take advantage of the subsidy even after hiring eligible workers.
source of the wage is important to workers, then employment subsidies may potentially harm worker effort in two ways. First, the workers who are hired as a result of an employment subsidy may not provide the same amount of effort on the job as unsubsidized workers if they suspect that they only have a job as a result of the subsidy and not because their employer values their skills. Second, other workers who are already employed without a subsidy may change their effort provision if they work alongside subsidized workers for the same wage. Some of the perceived generosity on the part of the firm, or the perhaps the extra satisfaction of having a job when others do not may be eroded by the subsidy. If either or both of these effects are present, an employment subsidy may in a sense cause workers to become less productive if it decreases the perceived gift on the part of the firm. As a result, it may be in the firm’s best interest not to employ subsidized workers even if they have the same skills and abilities as existing workers. If these factors are present, employment subsidies would have the exact opposite of the intended effect by making subsidized workers even less likely to find a job.

This chapter attempts to analyze the possibility that employment subsidies decrease employee effort on the job. Since effort is difficult to measure using field data, the analysis is conducted using laboratory gift exchange experiments performed in the framework established by Fehr et al. (1993). In the present experiment, a labor market is created that has the characteristics of gift exchange and also initial unemployment. An employment subsidy for the previously unemployed is then introduced into the market and the unemployment is eliminated. Two primary comparisons are then made to test

24 Conversely, the previously unemployed may respond with greater effort because they are glad to have a job.
whether effort is harmed by the subsidy. First the effort provided by workers covered by the subsidy is compared to the effort provided by those not covered by the subsidy over the same experimental periods, and for the same wage offers. No statistically significant differences in the behavior are found between the two groups. Second, the effort choices of the workers employed before the introduction of the subsidy are compared to the choices of the same workers when the subsidy is in place. This comparison reveals significantly reduced effort in the presence of the subsidy.

This chapter is organized as follows. Section 3.2 describes the experimental design. Section 3.3 presents the results. Section 3.4 concludes and discusses limitations and possible extensions of this study. Appendix D contains figures, Appendix E contains statistical tables, and Appendix F contains the experimental materials related to this chapter.

3.2 SUBSIDY EXPERIMENTAL DESIGN

In each session, subjects were divided into two main groups. One group was randomly chosen to be “managers” and the other group was chosen to be “employees”. The employees were further divided into two subgroups, “regular” workers and “unemployed” workers.25 In each period managers were asked to choose a wage for an employee (or employees). Each employee was then able to observe the wage that was offered to him/her. Wage offers were written directly on employee record sheets so that only the manager and employee involved in the contract knew the wage offer. After

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25 The terms “worker” and “employee” are used interchangeably.
receiving the wage, each employee was asked to choose an effort level, which was transmitted back to the manager in question.\textsuperscript{26} As such both wage offers and effort levels were private information for the manager and worker in each pairing.

The pairings were reassigned randomly before each period so that a worker and manager were not paired together more than twice and were never paired in two consecutive periods.\textsuperscript{27} Details regarding the random assignment of pairings were explained before the start of each session and were repeated before each of the first several periods within each session. Each participant was given a written copy of the instructions, which were read aloud to all participants.\textsuperscript{28}

Two sessions were conducted with ten total periods. In each of the first three periods, each manager made a wage offer only to one worker in the group of regular workers. The payoff functions for managers ($\Pi_M$) and regular workers ($\Pi_{RW}$) in periods 1-3 were

$$\Pi_M = 100 - w + 5e$$
$$\Pi_{RW} = 100 - e + 5w$$

where $w$ is the wage offer and $e$ is the effort provided. Both wages and effort are chosen from the interval [0,100].

In these periods the unemployed workers received a fixed payment of 70 experimental dollars. This amount is strictly less than the 100 experimental dollars that an employed worker can earn by providing an effort of zero regardless of the wage received.

\textsuperscript{26} The term “effort” is used throughout this paper but in the experiment “Amount of Work” was used in its place.
\textsuperscript{27} These procedures create a series of one-shot games so that the only motivation for offering efficiency wages is the potential gain from higher effort.
\textsuperscript{28} See Appendix F for the instructions and experimental materials.
This value was chosen in order to make unemployment much less attractive than employment as is likely the case in most labor markets. The employed workers received a wage in each of the first three periods, whereas the unemployed workers remained unemployed for each of the first three periods.

The firm’s payoff function and employee’s effort-cost relationship were provided to all managers and all employees so that this information was common knowledge. Participants were provided with calculators and were required to compute, correctly, the payoffs for both managers and employees in several examples prior to the start of the experiment.

These payoff functions are taken directly from prior gift exchange experiments by Owens and Kagel (2006) and are a rescaled version of the profit functions used in Brandts and Charness (2004). The fact that the manager’s profit function is linear holds the marginal costs and benefits constant for any given effort level. Managers were given 100 “offer notes” from which to pay a wage in each period, so that the maximum wage is 100.

After period 3 it was announced that an employment subsidy was put into effect. For these periods each manager was paired with two employees, one regular and one previously unemployed, and both sets of employees received a wage from the managers in these periods. In order to isolate the effect of the worker’s perceptions of the subsidy,

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29 An announcement was made and a new set of instructions was distributed that explained the new payoff functions, the new pairing system, and other details. After these instructions were read aloud subjects were required to correctly calculate a new set of examples.
the managers were forced to offer the same wage to both types of worker. The payoff functions for managers ($\Pi_M$) and employees ($\Pi_E$) in the periods 4-10 were

$$\Pi_M = 100 - w + 5e \quad \text{from regular worker}$$

$$\Pi_M = 100 - (1/2)w + 5e \quad \text{from the subsidized worker}$$

$$\Pi_E = 100 - e + 5w$$

with both wages and effort being chosen from the interval $[0,100]$. The managers earn the sum of the payoffs received from both workers in each period. In the context of this experiment it is worth noting that both employees are equally productive to the manager, and the structure does not allow a manager to discriminate in terms of the wage offered to each type. The only difference as far as the manager is concerned is that the wage paid to the previously unemployed worker is less costly. The employees all face the same payoffs in these periods, but they may respond differently due to the perceived differences or changes in the gift being provided by the manager.

An additional feature of this experiment “pairs” two workers, one regular and one subsidized together for the same randomized sequence of wage offers. To provide an additional control for the history faced by the employees. This may be important given the findings in previous gift exchange experiments where employees are observed to respond favorably to wage offers that are greater than any previous wage received (see, Owens & Kagel, 2006). By pairing employees in this way the wage history that is

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30 In the context of these experiments it is likely that a manager would offer a lower wage to a regular worker relative to the wage offered to a subsidized worker because the wage cost is greater for a regular worker. However, in field settings it seems unlikely that the firm would pay a subsidized worker more than an unsubsidized worker.
observed can be held constant between two employees. This additional control imposes that any systematic differences in effort responses must be attributed to the influence of the subsidy rather than to the sequence of wage offers.\footnote{In order to maintain the one shot nature of each period it is necessary to reassign different employees to different managers in order to eliminate reputation effects. However, it is not necessary for two employees paired with the same manager in one period to each be paired with different managers in the next period since the choices made by employees have no direct effect on other employees within a period.}

Participants were paid privately and individually at the rate of 250 experimental dollars to 1 US dollar along with a $6 participation fee. Average earnings were approximately $19.85 for regular workers, $16.30 for unemployed workers and $16.45 for managers. Sessions lasted about one hour and fifteen minutes.

3.3 RESULTS

Table 18 in Appendix E displays the summary statistics for the mean effort provided by the two types of worker. The first data column presents the data for all periods, the second column presents data only for the first three periods, and the third column present data for the last seven periods. The mean wage offer was 57.6 in the first 3 periods and 51.19 in the last seven periods. The mean effort choice of 18.88 for the subsidized workers in the last seven periods is similar to the mean effort of 17.02 provided by the regular workers. In addition, the mean effort provided by regular workers decreased from 24.21 before the subsidy to 17.02 with the subsidy. Figure 16 in Appendix D displays the mean wage and effort choices by period for each of the three groups.

Figure 17 displays the kernel regressions for the relationship between wages and effort for the subsidized and unsubsidized workers in periods 4-10. It is fairly clear from
the figures that there are no systematic differences between the two types of worker. The
two types respond with very similar effort for any given wage offer. This is confirmed by
the random effects Tobit regressions of effort presented in Table 19 which include a
Regular Worker dummy variable (Regular Worker = 1 if the worker is not subsidized,
and 0 otherwise) and an interaction variable Regular Worker*Wage. Both Regular
Worker and Regular Worker*Wage are found not to be significant alone, and are also not
jointly significant from zero ($\chi^2 (2) = 1.35, P=0.51$).

Figure 18 displays the kernel regressions for the relationship between wages and
effort choices for the regular workers before versus with the subsidy. This figure shows
that for all wage offers less than 75 the regular workers provide more effort before the
subsidy is in place. Table 20 presents several specifications of random effects Tobit
regressions on effort for the group of regular workers. The Subsidy Period dummy
variable (Subsidy Period = 1 if the subsidy is in place for the period, and 0 otherwise) is
negative and significant at the 5% level when only Wage and the Subsidy Period dummy
are included as independent variables. When a term for interaction of the subsidy period
dummy and the wage (Subsidy Period*Wage) is included neither of these two variables
are significant alone. However, a joint test of these two variables finds them to be jointly
negative and significant from zero at the 5% level ($\chi^2 (2) = 6.45, P= 0.040$).

There are several possible reasons for the decrease in effort on the part of the
employed workers. First, they may perceive a greater gift from being employed when
others are not. Second, the workers may be “free-riding” in the subsidy periods because if
they do not offer high effort, the managers are partially compensated because they now
employ two workers. Third, it could be a function of the experimental design which allows everyone more time to think about their decisions.

Additional random effects Tobit regressions are estimated in order to investigate whether the higher effort observed in the first three periods is due to learning on the part of the employees. Table 21 presents results for regressions which include dummy variables indicating the number of wage offers that have been received. This specification captures if, for instance, there is some learning effect over the first three offers that have been received.\footnote{Regular workers receive their first offer in period 1 whereas subsidized workers receive their first offer in period 4.} If subsidized workers also provide greater effort in the first three periods than in those that follow, the trend observed in the unsubsidized workers can likely be attributed to learning. However, this does not appear to be the case. None of the offer dummy variables for the first three offers are significant in the pooled sample, or in the sample of previously unemployed workers, but for the sub sample of regular workers the dummy variables corresponding to each of the first three periods indicate a positive and significant effect. In other words, in the periods prior to the subsidy employees are offering higher effort for given wages holding all else constant.

Table 22 presents random effects Tobit regressions of wages. These indicate that the wage offered and the average effort received in the prior period have a positive and significant effect on the wage offer in a given period. Managers clearly consider the effort that they have received in the past when making wage offers. The third column of Table 22 indicates that the dummy variable for the subsidy periods is negative and significant when it is the only independent variable included in the regression. This suggests that lower wages are offered in the presence of the subsidy, however this effect
is no longer significant when lagged effort is added as an independent variable in column four.

3.4 DISCUSSION AND CONCLUSION

This paper examines the behavioral effects of employment subsidies on worker effort in labor markets characterized by gift exchange. An experimental labor market is constructed which begins with a high level of unemployment. Then an employment subsidy is introduced to eliminate the unemployment. For the periods after the introduction of the subsidy, workers who are covered by the subsidy do not behave any differently than the workers not covered by the subsidy. The subsidized workers provide slightly greater effort, although this difference is not statistically significant. The results of the subsidy sessions are consistent with several previous gift exchange experiments in that employees do not tend to consider differences in the costs to the managers. For example, in previous work Hannan (in press) does not find significant differences between employees interacting with a high productivity or low productivity firm. Brandts and Charness (2004) do not find significant differences in employee effort provision in cases with an excess supply of labor versus cases with an excess supply of firms. In both studies employees do not respond to the different costs that the firms are incurring.

However, there is some evidence that the previously employed workers reduce their effort for given wages after the introduction of the subsidy. The difference is statistically significant even when making allowances for some potential learning effects. The decrease in effort in the presence of the subsidy arises even though those workers themselves are not directly receiving the subsidy. The results from this experiment
provide some evidence that gift exchange motivations may play a role in employment subsidy programs through the reduction in effort for those not receiving the subsidy. This study does not rule out other explanations for the ineffectiveness of subsidies relating to stigma and selection as potential problems, but rather points to decreased motivation on the part of workers as another potential contributing factor.

This experiment has some limitations. In order to isolate the effect the employment subsidy on gift exchange worker productivity was held constant for both employee types. This restriction could be relaxed so that the previously unemployed are in fact less productive than the previously employed. This change may lead the previously employed to reduce their effort if they are offered the same wage as a lower productivity worker.
CHAPTER 4

CONCLUSION

This dissertation examines the effect of wage and employment policies on worker effort in experimental labor markets characterized by gift exchange. The evidence indicates that the presence of gift exchange leads to different outcomes than are predicted by standard economic theory which does not account for such motivations.

In the presence of gift exchange, at the very least introducing minimum wages into ongoing labor markets does not appear to harm effort. For low wage offers, effort decreases when the minimum wage is introduced, however, this effect is not statistically significant. For higher wage offers the amount of effort provided actually increases in the presence of the minimum wage relative to before it was imposed. In one specification of this experiment the increase in effort is statistically significant and in another it is not significant. This increase in effort results from the fact that employees are receiving higher wages than before and they react to this increase in wage with greater effort.

A comparison of sessions that begin without a minimum wage and sessions that start with a minimum wage presents a very different picture. From this comparison it
appears that the presence of a minimum wage has a nearly universal negative influence on effort. Wage offers are similar for the two groups, but effort is significantly lower in the sessions that start with the minimum wage.

The difference between the two types of comparison highlights the importance of reference points in market situations. The subjects that begin in a market without a minimum wage experience an increase in wages as a result of the policy change. This increase relative to the past leads them to provide greater effort. Subjects who begin in a market with a minimum wage do not have another reference with which to compare their wage and they establish norms relative to this frame. As a result they do not provide greater effort.

This difference illustrates an important consideration for experimental design. In actual labor markets employees experience changes in minimum wage policy in reference to the existing wage norms. As a result the conclusions drawn from the comparison of effort choices within ongoing labor markets have more ecological validity in that they are better able to capture the behavioral responses that employees are likely to make.

The effect of removing the minimum wage in these experiments also has different outcomes for different specifications. For sessions that began without a minimum wage, and then introduced a minimum wage, the subsequent removal of the minimum wage does not have much of an effect on the market. Wages and effort remain at the relatively high levels that were observed in the presence of the minimum wage. For sessions that began with a minimum wage removing the minimum wage caused a dramatic reduction in wage offers. The effort provided for a given wage remained constant, but as wages
decreased so did effort. Consequently, the periods following the minimum wage in these sessions are observed to have lower wages, lower effort, and thus lower profits for both managers and employees.

The introduction of employment subsidies in an experimental labor market characterized by gift exchange and initial unemployment also shows the importance of wage perceptions. The effort responses made by the workers who were previously unemployed are not statistically different from the responses made by the previously employed. However, the addition of employed workers as a result of the subsidy tends to harm the effort provided by those who were previously employed. In other words, less effort is provided by previously employed workers, for given wages, after the subsidy is put into effect. In this way subsidies may harm the effort of existing workers.

These experiments related to wage and employment policies shed light on the importance of accounting for other regarding preferences and the impact of norms on behavior. Achieving a greater understanding of such forces and their interaction with policy decisions is an important consideration for economists and policy makers.
APPENDIX A

MINIMUM WAGE FIGURES
Figure 1: Average Wage and Effort by Period: Experiment 1 (sessions 1 and 2)

Figure 2: Kernel Regressions of Effort as a Function of Wages in Experiment 1
(Comparison with and without a Minimum Wage within Sessions 1 and 2)
Figure 3: Histogram of Wages in Sessions 1 and 2

Figure 4: Average Wage and Effort in Experiment 1: Comparison of Sessions 1 and 2 (No Minimum Wage) with Sessions 3 and 4 (Minimum Wage)
Figure 5: Kernel Regressions of Effort as a Function of Wages in Experiment 1:
Comparison of Sessions 1 and 2 (No Minimum Wage) to Sessions 3 and 4 (With Minimum Wage)
Figure 6: Kernel Regressions of Effort as a Function of Wages: After Setting the Zero Wage Reference Point in Sessions 3 and 4 at the Minimum Wage
Figure 7: Histogram of Wages in Periods 1-5: Sessions 1 and 2 versus Sessions 3 and 4

Figure 8: Histogram of Wages under the Minimum Wage Condition: Sessions 1 and 2 versus Sessions 3 and 4
Figure 9: Mean Effort and Wage by Period After Dropping the Minimum Wage: Experiment 1
Figure 10: Histogram of Wages in Sessions 3 and 4

Figure 11: Average Wage and Effort by Period: Experiment 2
Figure 12: Kernel Regressions of Effort as a Function of Wages in Experiment 2
(Comparison with and without a Minimum Wage)

Figure 13: Histogram of Wages in Experiment 2
APPENDIX B

MINIMUM WAGE STATISTICAL TABLES
B.1 INTRODUCTION

This Appendix reports descriptive statistics and the results of statistical tests of the treatment effects reported in Chapter 2 of the text. Random effects Tobits and random effects ordered probits are used throughout. Random effects are used in order to account for the repeated observations of the same individuals in these experiments. Since the set of effort choices available to the employees is constrained, any regressions with effort as the dependent variable must account for this censoring. All of the Tobits reported here account for censoring of effort at both the minimum of 1 and the maximum of 10 in Experiment 1, and at 0 and 100 for Experiment 2.

The ordered probits reported here were estimated by grouping effort responses into five effort ranges. For Experiment 1 the first range corresponds to effort levels from 1-2, the second range to effort levels 3-4, the third range to effort levels 5-6, the fourth range to effort levels 7-8, and the last range to effort levels 9-10. For Experiment 2 the first range corresponds to effort less than 20, the second range refers to effort greater than 20 but less than or equal to 40, the third refers to effort greater than 40 but less than or equal to 60, and so on up to the highest range which corresponds to effort greater than 80.

The tables also report the marginal effects on effort implied by each set of estimates at different wage rates where relevant. The Tobit specification restricts the relationship to a linear form whereas the ordered probit specification does not have this
restriction. However, the marginal effects of the Tobit are somewhat easier to interpret than the ordered probits and in most cases the significance and comparative statics are similar.

For the Tobits the estimated marginal effects from a minimum wage are expressed as changes in the level of effort provided. For the ordered probits the marginal effects are expressed as changes in the probability that the effort level chosen falls within a particular effort range for a given wage offer. These effects are estimated for a given wage by subtracting the probability that the effort choice will fall in a given effort range without a minimum wage from the probability that effort falls in that range with a minimum wage. The tables display this difference in probability for the probit estimates. For example, the interpretation of the value 0.074 in the first cell of Table 3 is that for a given wage of 40, the probability of choosing an effort level in the range from 1-2 increases by 7.4% when the minimum wage is in place relative to when it is not in place. Under the minimum wage employees are 7.4% more likely to provide the lowest effort (an effort from 1-2) in response to a wage offer of 40 than if the minimum wage were not present. Since all the results are in terms of changes in probability, each column sums to zero.

B.2 EXPERIMENT 1

B.2.1 Effects on Effort of the Minimum Wage within an Ongoing Labor Market:

Table 1 reports a number of specifications for the effect of the minimum wage requirement on effort. The most relevant specification is the one in column four which
introduces both a dummy variable for the minimum wage (MW = 1 with a minimum wage, 0 otherwise) and an interaction effect between wage and the minimum wage dummy (Wage*MW).

The dummy variable for the minimum wage effect is negative but not statistically significant at conventional levels, while the Wage*MW variable is positive and significant at the 5% level. Evaluating the joint impact of these two variables (see the seventh data column of Table 1) the cutoff point for which the minimum wage has zero impact is 52.8. For wages below this cutoff point effort is lower with the minimum wage, but not significantly lower, compared to before the minimum wage. For wages above this cutoff point effort is higher in the presence of the minimum wage than it was before, with this difference statistically significant at the highest wage rates (80 and above). The same trend is also verified by the marginal effects implied by the ordered probits in Table 3 which shows a positive and significant increase in the probability that a wage of 100 will be met with an effort of 9 or 10.

Table 4 shows the movement of wages by manager between treatments. Since some of the managers make wage offers in more than one wage range over the five periods within each treatment, these changes in wage are noisy and tracking them is not completely straightforward. Some assumption about how the wage offers made by each manager change must be made. Here the wages offers by each manager are sorted from smallest to largest within each treatment and offer of the same rank in each treatment are compared. For example, the smallest offer made by an individual manager in periods 1-5 is assumed to move into the cell corresponding to the smallest offer in periods 6-10, and then to the cell corresponding to the smallest offer in periods 11-15. The same is done for
the second smallest offer made by each manager in each of the treatments. Any bias resulting from this method of classification is likely to be small as most managers offer wages that fall within only one or two ranges.

<table>
<thead>
<tr>
<th>Dependent Variable is Effort&lt;sup&gt;a&lt;/sup&gt;</th>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
<th>(5)</th>
<th>Wage</th>
<th>Marginal Effect of MW (4)</th>
<th>Marginal Effect of MW (5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>MW</td>
<td>2.593*** (0.646)</td>
<td>0.697* (0.412)</td>
<td>-1.847 (1.353)</td>
<td>4.870 (4.105)</td>
<td>40</td>
<td>-0.431 (0.701)</td>
<td>0.098 (0.835)</td>
<td></td>
</tr>
<tr>
<td>Wage</td>
<td>0.132*** (0.010)</td>
<td>0.129*** (0.010)</td>
<td>0.114*** (0.012)</td>
<td>0.173*** (0.054)</td>
<td>60</td>
<td>0.277 (0.159)</td>
<td>-0.367 (0.579)</td>
<td></td>
</tr>
<tr>
<td>Wage* MW</td>
<td>0.035** (0.018)</td>
<td>-0.183 (0.124)</td>
<td>-0.183 (0.124)</td>
<td>80</td>
<td>0.985** (0.435)</td>
<td>0.449 (0.528)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wage&lt;sup&gt;2&lt;/sup&gt;</td>
<td></td>
<td>-0.000 (0.000)</td>
<td></td>
<td>100</td>
<td>1.693*** (0.653)</td>
<td>2.545*** (0.815)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wage&lt;sup&gt;2&lt;/sup&gt;* MW</td>
<td></td>
<td>0.002* (0.001)</td>
<td></td>
<td>Cutoff wage</td>
<td>52.8</td>
<td>73</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Constant</td>
<td>3.272*** (0.849)</td>
<td>-4.254*** (0.808)</td>
<td>-4.387*** (0.802)</td>
<td>-3.344*** (0.919)</td>
<td>-4.836*** (1.675)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Joint test</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>χ&lt;sup&gt;2&lt;/sup&gt; = 6.73</td>
<td>P = 0.035**</td>
<td></td>
</tr>
<tr>
<td>MW and Wage* MW</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>χ&lt;sup&gt;2&lt;/sup&gt; = 9.80</td>
<td>P = 0.020**</td>
</tr>
<tr>
<td>Joint test of Wage&lt;sup&gt;2&lt;/sup&gt; and Wage&lt;sup&gt;2&lt;/sup&gt;* MW</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>χ&lt;sup&gt;2&lt;/sup&gt; = 3.35</td>
<td>P = 0.187</td>
</tr>
</tbody>
</table>

MW = 1 if minimum wage is in effect; 0 otherwise. * Number of observations is 198 in all cases. Two observations where the employee lost money were dropped from the sample.

*Significantly different from 0 at the 10% level, two tailed test.
***Significantly different from 0 at the 5% level, two-tailed test.
****Significantly different from 0 at the 1% level, two-tailed test.

Standard errors are in parentheses.

Table 1: Random Effects Tobits for the Effects on Effort of the Minimum Wage within an Ongoing Labor Market: Experiment 1 (periods 1-10, sessions 1 and 2)
<table>
<thead>
<tr>
<th>Dependent Variable is Effort</th>
<th>5 effort ranges (N=198)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wage</td>
<td>0.051*** (0.006)</td>
</tr>
<tr>
<td>MW</td>
<td>-0.741 (0.626)</td>
</tr>
<tr>
<td>Wage*MW</td>
<td>0.013 (0.008)</td>
</tr>
<tr>
<td>Cut 1</td>
<td>2.443*** (0.436)</td>
</tr>
<tr>
<td>Cut 2</td>
<td>3.391*** (0.462)</td>
</tr>
<tr>
<td>Cut 3</td>
<td>4.100*** (0.490)</td>
</tr>
<tr>
<td>Cut 4</td>
<td>5.268*** (0.525)</td>
</tr>
<tr>
<td>rho</td>
<td>0.693*** (0.121)</td>
</tr>
<tr>
<td>Joint test of MW and wage*MW</td>
<td>$\chi^2 (2)=3.86$ P=0.145</td>
</tr>
</tbody>
</table>

*Significantly different from 0 at the 10% level, two tailed test.
**Significantly different from 0 at the 5% level, two-tailed test.
***Significantly different from 0 at the 1% level, two-tailed test.
Standard errors are in parentheses.

Table 2: Random Effects Ordered Probit for the Effects on Effort of the Minimum Wage within an Ongoing Labor Market: Experiment 1 (periods 1-10, sessions 1 and 2)
Table 3: Marginal Effects of the Minimum Wage for Random Effects Ordered Probit
within an Ongoing Labor Market (periods 1-10, sessions 1-2)

<table>
<thead>
<tr>
<th>Effort Range</th>
<th>40</th>
<th>60</th>
<th>80</th>
<th>100</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-2</td>
<td>0.074</td>
<td>-0.017</td>
<td>-0.027</td>
<td>-0.004</td>
</tr>
<tr>
<td></td>
<td>(0.101)</td>
<td>(0.065)</td>
<td>(0.029)</td>
<td>(0.007)</td>
</tr>
<tr>
<td>3-4</td>
<td>-0.045</td>
<td>-0.002</td>
<td>-0.063</td>
<td>-0.032</td>
</tr>
<tr>
<td></td>
<td>(0.068)</td>
<td>(0.014)</td>
<td>(0.041)</td>
<td>(0.040)</td>
</tr>
<tr>
<td>5-6</td>
<td>-0.021</td>
<td>0.007</td>
<td>-0.034</td>
<td>-0.071</td>
</tr>
<tr>
<td></td>
<td>(0.025)</td>
<td>(0.028)</td>
<td>(0.033)</td>
<td>(0.056)</td>
</tr>
<tr>
<td>7-8</td>
<td>-0.008</td>
<td>0.010</td>
<td>0.053</td>
<td>-0.121</td>
</tr>
<tr>
<td></td>
<td>(0.008)</td>
<td>(0.041)</td>
<td>(0.054)</td>
<td>(0.073)</td>
</tr>
<tr>
<td>9-10</td>
<td>-0.000</td>
<td>0.002</td>
<td>0.072</td>
<td>0.227*</td>
</tr>
<tr>
<td></td>
<td>(0.000)</td>
<td>(0.008)</td>
<td>(0.054)</td>
<td>(0.116)</td>
</tr>
</tbody>
</table>

*Significantly different from 0 at the 10% level, two tailed test.
**Significantly different from 0 at the 5% level, two-tailed test.
***Significantly different from 0 at the 1% level, two-tailed test.
Standard errors are in parentheses.

Table 4: Number of Observations within Each Wage Range: Before versus MW, Sessions 1 and 2

<table>
<thead>
<tr>
<th>Wage Range in Periods 1-5 (Before)</th>
<th>Wage Range in Periods 6-10 (MW)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>40-60 (N=27)</td>
</tr>
<tr>
<td>0-40 (N=28)</td>
<td>17</td>
</tr>
<tr>
<td>41-60 (N=25)</td>
<td>9</td>
</tr>
<tr>
<td>61-80 (N=22)</td>
<td>1</td>
</tr>
<tr>
<td>81-100 (N=25)</td>
<td>0</td>
</tr>
</tbody>
</table>

Table 4: Number of Observations within Each Wage Range: Before versus MW, Sessions 1 and 2
<table>
<thead>
<tr>
<th></th>
<th>Random Effects Tobit</th>
<th>Random Effects Tobit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wage</td>
<td>0.101*** (0.014)</td>
<td>0.101*** (0.015)</td>
</tr>
<tr>
<td>MW</td>
<td>-1.280 (1.381)</td>
<td>-1.448 (1.601)</td>
</tr>
<tr>
<td>HW</td>
<td>1.020* (0.608)</td>
<td>1.107 (0.738)</td>
</tr>
<tr>
<td>Wage*MW</td>
<td>0.030* (0.018)</td>
<td>0.033 (0.024)</td>
</tr>
<tr>
<td>HW*MW</td>
<td>-0.240 (1.156)</td>
<td></td>
</tr>
<tr>
<td>Constant</td>
<td>-2.850*** (0.986)</td>
<td>-2.819*** (0.994)</td>
</tr>
<tr>
<td>N=198</td>
<td>N=198</td>
<td></td>
</tr>
<tr>
<td>Joint test of HW and HW*MW</td>
<td>$\chi^2 (2)=2.88$</td>
<td>$P=0.237$</td>
</tr>
</tbody>
</table>

MW = 1 if minimum wage is in effect, 0 otherwise; HW = 1 if the wage received this period is greater than any wage received in previous periods, 0 otherwise.

*Significantly different from 0 at the 10% level, two tailed test.
**Significantly different from 0 at the 5% level, two-tailed test.
***Significantly different from 0 at the 1% level, two-tailed test.
Standard errors are in parentheses.

Table 5: Random Effects Tobits for the Effect of Current versus Past Wages on Effort:

Experiment 1 (periods 1-10, sessions 1 and 2)
B.2.2 Effects on Effort of a Minimum Wage Comparing Between Markets that Begin With a Minimum Wage versus Markets with No Minimum Wage

Random effects Tobits for the between group effect of the minimum wage are reported in Table 6, along with the implied effects on effort at different wage rates. The different specifications for the Tobits are dropped to conserve space. The coefficient estimates for the minimum wage effect have a similar pattern to the results reported in Table 1 for sessions 1 and 2 – the intercept dummy for the minimum wage effect (MW) is negative and the MW*Wage interaction effect is positive, with the MW variable statistically significant at the 1% level. The big difference between the two cases is that the minimum wage dummy is three times larger in absolute value here compared to Table 1, so that the effort level is lower over all wages with the minimum wage here (the cutoff point is greater than 100), and significantly lower for all but the very highest wage rates (91-100).

The marginal effects in the last column of Table 6 indicate that lower effort is provided in the presence of the minimum wage for all but the highest wages. Similarly, Table 8 indicates that with a minimum wage, the probability of receiving the lowest effort response of 1 or 2 increases significantly for wages less than 70 comparing between groups. These results are consistent with Brandts and Charness (2004).

Table 9 reports the random effects Tobit which tests whether employees in sessions 3 and 4 are treating deviations from the minimum wage of 40 in the same way as those in sessions 1 and 2 treated deviations from the zero wage. We pooled the data from sessions 1 and 2 with 3 and 4, subtracted 40 from all wages in sessions 3 and 4, and restricted the analysis to wages (and adjusted wages) of 60 or less. Using the same
specification as in Table 6, but replacing the MW dummy with a dummy variable D34 = 1 for sessions 3 and 4, 0 otherwise, and replacing the Wage*MW term with Wage*D34, neither the D34 dummy nor the Wage*D34 variable is significant on its own account.

Further, a joint test fails to reject the null hypothesis that both variables are jointly equal to 0 ($\chi^2 (2) = 1.10, p = 0.58$).

<table>
<thead>
<tr>
<th>Dependent Variable is Effort</th>
<th>Random Effects Tobit</th>
<th>Random Effects Tobit</th>
<th>Wage</th>
<th>Marginal Effect of Minimum Wage (Column 2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>MW</td>
<td>-5.852*** (1.664)</td>
<td>-11.401** (5.334)</td>
<td>40</td>
<td>-4.719*** (1.010)</td>
</tr>
<tr>
<td>Wage</td>
<td>0.122*** (0.012)</td>
<td>0.163*** (0.051)</td>
<td>60</td>
<td>-4.153*** (1.068)</td>
</tr>
<tr>
<td>Wage*MW</td>
<td>0.028 (0.029)</td>
<td>0.198 (0.168)</td>
<td>80</td>
<td>-3.586** (1.387)</td>
</tr>
<tr>
<td>Wage^2</td>
<td>-0.000 (0.000)</td>
<td>-0.001 (0.001)</td>
<td>100</td>
<td>-3.020 (1.836)</td>
</tr>
<tr>
<td>Wage^2*MW</td>
<td></td>
<td></td>
<td></td>
<td>Cutoff wage 209</td>
</tr>
<tr>
<td>Constant</td>
<td>-4.054*** (0.886)</td>
<td>-5.051*** (1.549)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Joint test of MW and Wage*MW</td>
<td>$\chi^2 (2)=21.85$</td>
<td>$\chi^2 (2)=2.52$</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

MW = 1 if minimum wage is in effect, 0 otherwise. * Number of observations is 188. Two observations where the employee lost money were dropped from the sample.

*Significantly different from 0 at the 10% level, two tailed test.

**Significantly different from 0 at the 5% level, two-tailed test.

***Significantly different from 0 at the 1% level, two-tailed test.

Standard errors are in parentheses.

Table 6: Random Effects Tobits for the Between Group Effect of Minimum Wages on Effort: Experiment 1 (first five periods of sessions 1-4)
Table 7: Random Effects Ordered Probit for the Between Group Effect of the Minimum Wage on Effort: Experiment 1 (first five periods of sessions 1-4)

<table>
<thead>
<tr>
<th>Dependent Variable is Effort</th>
<th>5 effort ranges (N=188)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wage</td>
<td>0.061*** (0.008)</td>
</tr>
<tr>
<td>MW</td>
<td>-1.615* (0.890)</td>
</tr>
<tr>
<td>Wage*MW</td>
<td>0.007 (0.011)</td>
</tr>
<tr>
<td>Cut 1</td>
<td>3.075*** (0.519)</td>
</tr>
<tr>
<td>Cut 2</td>
<td>4.087*** (0.572)</td>
</tr>
<tr>
<td>Cut 3</td>
<td>5.016*** (0.633)</td>
</tr>
<tr>
<td>Cut 4</td>
<td>6.018*** (0.687)</td>
</tr>
<tr>
<td>rho</td>
<td>0.771*** (0.059)</td>
</tr>
<tr>
<td>Joint test of MW and wage*MW</td>
<td>$\chi^2(2)=10.88$ P=0.004***</td>
</tr>
</tbody>
</table>

*Significantly different from 0 at the 10% level, two tailed test.
**Significantly different from 0 at the 5% level, two-tailed test.
***Significantly different from 0 at the 1% level, two-tailed test.
Standard errors are in parentheses.
Table 8: Marginal Effects of the Minimum Wage for Random Effects Ordered Probit

Between Group Effect (first five periods of sessions 1-4)

<table>
<thead>
<tr>
<th>Effort Range</th>
<th>40</th>
<th>60</th>
<th>80</th>
<th>100</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-2</td>
<td>0.234*** (0.082)</td>
<td>0.442*** (0.120)</td>
<td>0.188 (0.151)</td>
<td>0.016 (0.029)</td>
</tr>
<tr>
<td>3-4</td>
<td>-0.187*** (0.054)</td>
<td>-0.168 (0.143)</td>
<td>0.192 (0.093)</td>
<td>0.095 (0.100)</td>
</tr>
<tr>
<td>5-6</td>
<td>-0.042 (0.025)</td>
<td>-0.196 (0.062)</td>
<td>-0.063 (0.175)</td>
<td>0.173* (0.081)</td>
</tr>
<tr>
<td>7-8</td>
<td>-0.005 (0.004)</td>
<td>-0.070 (0.055)</td>
<td>-0.210*** (0.063)</td>
<td>0.031 (0.204)</td>
</tr>
<tr>
<td>9-10</td>
<td>0.000 (0.000)</td>
<td>-0.008 (0.011)</td>
<td>-0.108 (0.108)</td>
<td>-0.315 (0.186)</td>
</tr>
</tbody>
</table>

*Significantly different from 0 at the 10% level, two tailed test.
**Significantly different from 0 at the 5% level, two-tailed test.
***Significantly different from 0 at the 1% level, two-tailed test.
Standard errors are in parentheses.

Table 9: Random Effects Tobit for the Wage Adjusted Between Group Effect of Minimum Wages on Effort: Experiment 1 (first five periods of sessions 1-4)

<table>
<thead>
<tr>
<th>Dependent Variable</th>
<th>D34</th>
<th>Adjusted Wage</th>
<th>Adjusted Wage*D34</th>
<th>Constant</th>
<th>Joint test of D34 and Wage*D34</th>
</tr>
</thead>
<tbody>
<tr>
<td>Random Effects Tobit (N=141)</td>
<td>1.883 (2.102)</td>
<td>0.164*** (0.040)</td>
<td>-0.010 (0.049)</td>
<td>-6.116*** (2.002)</td>
<td>$\chi^2 (2)=1.10$ P=0.58</td>
</tr>
</tbody>
</table>

D34 = 1 if observation is from sessions 3 and 4, 0 otherwise. Wage in sessions 3 and 4 equals actual wage less 40.

*Significantly different from 0 at the 10% level, two tailed test.
**Significantly different from 0 at the 5% level, two-tailed test.
***Significantly different from 0 at the 1% level, two-tailed test.
Standard errors are in parentheses.
B.2.3 The Effects of Eliminating the Minimum Wage

Table 10 reports the random effects Tobits and Table 11 reports the random effects ordered probits which test for the effect on effort for removing the minimum wage in the two types of session in Experiment 1. We are unable to reject a null hypothesis that removing the minimum wage treatment had no significant effect on effort in sessions 1 and 2 or in sessions 3 and 4. None of the marginal effects reported in Tables 12 and 13 are found to be significant.

Table 14 shows the movement in wage offers from the first five periods (before the minimum wage) to the last five periods (after the minimum wage). It is clear that the wage offers have shifted upward for the final five periods.
The Dependent Variable is Effort

<table>
<thead>
<tr>
<th></th>
<th>Sessions 1 and 2</th>
<th>Sessions 1 and 2</th>
<th>Sessions 3 and 4</th>
<th>Sessions 3 and 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>MW</td>
<td>-0.386 (2.074)</td>
<td>5.086 (5.754)</td>
<td>-0.815 (2.512)</td>
<td>-5.094 (7.220)</td>
</tr>
<tr>
<td>Wage</td>
<td>0.145*** (0.018)</td>
<td>0.146*** (0.066)</td>
<td>0.142*** (0.021)</td>
<td>0.058 (0.069)</td>
</tr>
<tr>
<td>Wage*MW</td>
<td>0.012 (0.026)</td>
<td>-0.155 (0.172)</td>
<td>0.002 (0.035)</td>
<td>0.184 (0.222)</td>
</tr>
<tr>
<td>Wage²</td>
<td>-0.000 (0.001)</td>
<td>0.000 (0.001)</td>
<td>0.001 (0.001)</td>
<td>0.001 (0.001)</td>
</tr>
<tr>
<td>Wage²*MW</td>
<td>0.001 (0.001)</td>
<td>-0.002 (0.002)</td>
<td>-0.002 (0.002)</td>
<td>-0.002 (0.002)</td>
</tr>
<tr>
<td>Constant</td>
<td>-5.388*** (1.581)</td>
<td>-5.414*** (2.026)</td>
<td>-9.104*** (2.155)</td>
<td>-7.668*** (2.400)</td>
</tr>
<tr>
<td>N</td>
<td>200</td>
<td>200</td>
<td>180</td>
<td>180</td>
</tr>
<tr>
<td>Joint test of MW and Wage*MW</td>
<td>χ²(2)=1.04, P=0.595</td>
<td>χ²(2)=0.73, P=0.693</td>
<td>χ²(2)=1.73, P=0.420</td>
<td></td>
</tr>
</tbody>
</table>

MW = 1 if minimum wage is in effect, 0 otherwise.
*Significantly different from 0 at the 10% level, two tailed test.
**Significantly different from 0 at the 5% level, two-tailed test.
***Significantly different from 0 at the 1% level, two-tailed test.
Standard errors are in parentheses.

Table 10: Random Effects Tobits for Impact of Removing Minimum Wage on Effort:

Experiment 1
<table>
<thead>
<tr>
<th>Dependent Variable is Effort</th>
<th>Session 1-2 5 effort ranges (N=200)</th>
<th>Sessions 3-4 5 effort ranges (N=180)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wage</td>
<td>0.050*** (0.007)</td>
<td>0.063*** (0.011)</td>
</tr>
<tr>
<td>MW</td>
<td>0.198 (0.756)</td>
<td>0.740 (1.013)</td>
</tr>
<tr>
<td>Wage*MW</td>
<td>0.000 (0.009)</td>
<td>-0.012 (0.013)</td>
</tr>
<tr>
<td>Cut 1</td>
<td>2.790*** (0.626)</td>
<td>4.681*** (0.943)</td>
</tr>
<tr>
<td>Cut 2</td>
<td>3.314*** (0.634)</td>
<td>5.385*** (0.953)</td>
</tr>
<tr>
<td>Cut 3</td>
<td>3.723*** (0.643)</td>
<td>6.110*** (0.992)</td>
</tr>
<tr>
<td>Cut 4</td>
<td>4.937*** (0.671)</td>
<td>6.710*** (1.038)</td>
</tr>
<tr>
<td>rho</td>
<td>0.363*** (0.108)</td>
<td>0.886*** (0.037)</td>
</tr>
<tr>
<td>Joint test of MW and wage*MW</td>
<td>$\chi^2 (2)=1.40$ P=0.496</td>
<td>$\chi^2 (2)=1.18$ P=0.555</td>
</tr>
</tbody>
</table>

*Significantly different from 0 at the 10% level, two tailed test.
**Significantly different from 0 at the 5% level, two-tailed test.
***Significantly different from 0 at the 1% level, two-tailed test.

Standard errors are in parentheses.

Table 11: Random Effects Ordered Probits for the Effects on Effort of Removing the Minimum Wage within an Ongoing Labor Market: Experiment 1
Table 12: Marginal Effects of the Minimum Wage for Random Effects Ordered Probit
within an Ongoing Labor Market (periods 6-15, sessions 1 and 2)

<table>
<thead>
<tr>
<th>Effort Range</th>
<th>40</th>
<th>60</th>
<th>80</th>
<th>100</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-2</td>
<td>-0.064 (0.146)</td>
<td>-0.080 (0.091)</td>
<td>-0.038 (0.035)</td>
<td>-0.007 (0.014)</td>
</tr>
<tr>
<td>3-4</td>
<td>0.025 (0.050)</td>
<td>-0.001 (0.023)</td>
<td>-0.026 (0.022)</td>
<td>-0.012 (0.020)</td>
</tr>
<tr>
<td>5-6</td>
<td>0.017 (0.039)</td>
<td>0.013 (0.011)</td>
<td>-0.016 (0.021)</td>
<td>-0.017 (0.023)</td>
</tr>
<tr>
<td>7-8</td>
<td>0.020 (0.053)</td>
<td>0.053 (0.072)</td>
<td>0.022 (0.044)</td>
<td>-0.050 (0.059)</td>
</tr>
<tr>
<td>9-10</td>
<td>0.001 (0.005)</td>
<td>0.015 (0.031)</td>
<td>0.058 (0.066)</td>
<td>0.086 (0.100)</td>
</tr>
</tbody>
</table>

*Significantly different from 0 at the 10% level, two tailed test.
**Significantly different from 0 at the 5% level, two-tailed test.
***Significantly different from 0 at the 1% level, two-tailed test.
Standard errors are in parentheses.

Table 13: Marginal Effects of the Minimum Wage for Random Effects Ordered Probit
within an Ongoing Labor Market (periods 1-10, sessions 3 and 4)

<table>
<thead>
<tr>
<th>Effort Range</th>
<th>40</th>
<th>60</th>
<th>80</th>
<th>100</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-2</td>
<td>-0.012 (0.041)</td>
<td>-0.003 (0.088)</td>
<td>0.090 (0.113)</td>
<td>0.078 (0.107)</td>
</tr>
<tr>
<td>3-4</td>
<td>0.010 (0.033)</td>
<td>0.002 (0.051)</td>
<td>-0.009 (0.055)</td>
<td>0.076 (0.070)</td>
</tr>
<tr>
<td>5-6</td>
<td>0.002 (0.008)</td>
<td>0.001 (0.027)</td>
<td>-0.038 (0.048)</td>
<td>0.033 (0.129)</td>
</tr>
<tr>
<td>7-8</td>
<td>0.000 (0.001)</td>
<td>0.000 (0.007)</td>
<td>-0.026 (0.036)</td>
<td>-0.039 (0.082)</td>
</tr>
<tr>
<td>9-10</td>
<td>0.000 (0.000)</td>
<td>0.000 (0.002)</td>
<td>-0.018 (0.035)</td>
<td>-0.148 (0.196)</td>
</tr>
</tbody>
</table>

*Significantly different from 0 at the 10% level, two tailed test.
**Significantly different from 0 at the 5% level, two-tailed test.
***Significantly different from 0 at the 1% level, two-tailed test.
Standard errors are in parentheses.
Table 14: Number of Observations within Each Range: Before Versus After Sessions 1 and 2

B.3 EXPERIMENT 2

Table 15 reports the random effects Tobit and Table 16 reports that random effects ordered probit for the effect of the minimum wage treatment on employee effort within an ongoing labor market in Experiment 2.\textsuperscript{33} We are unable to reject a null hypothesis that the coefficient values for the minimum wage dummy (MW) and the MW*Wage variable are jointly equal to zero in the Tobit ($\chi^2 (2) = 2.83, p = 0.24$) and in the ordered probit ($\chi^2 (2) = 1.86, p = 0.39$).

\textsuperscript{33} Additional random effects Tobits were estimated which included Wage$^2$ and Wage$^2$*MW terms. We are unable to reject the null hypothesis that these two variables are jointly equal to zero ($\chi^2 (2) = 0.44, p = 0.804$).
The Dependent Variable is Effort

MW Wage Wage*MW Constant Joint test of MW and Wage*MW

<table>
<thead>
<tr>
<th></th>
<th>MW</th>
<th>Wage</th>
<th>Wage*MW</th>
<th>Constant</th>
<th>Joint test of MW and Wage*MW</th>
</tr>
</thead>
<tbody>
<tr>
<td>Random Effects Tobit</td>
<td>-10.244</td>
<td>0.712***</td>
<td>0.089</td>
<td>-18.495***</td>
<td>$\chi^2(2)=2.83$</td>
</tr>
<tr>
<td></td>
<td>(9.052)</td>
<td>(0.085)</td>
<td>(0.139)</td>
<td>(6.000)</td>
<td>P=0.243</td>
</tr>
</tbody>
</table>

MW = 1 if minimum wage is in effect, 0 otherwise. Number of observations is 200.

*Significantly different from 0 at the 10% level, two tailed test.

**Significantly different from 0 at the 5% level, two-tailed test.

***Significantly different from 0 at the 1% level, two-tailed test.

Standard errors are in parentheses.

Table 15: Random Effects Tobit for the Effects on Effort of the Minimum Wage within an Ongoing Labor Market: Experiment 2
<table>
<thead>
<tr>
<th>Dependent Variable is Effort</th>
<th>5 effort ranges (N=200)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wage</td>
<td>0.050*** (0.007)</td>
</tr>
<tr>
<td>MW</td>
<td>-0.174 (0.579)</td>
</tr>
<tr>
<td>Wage*MW</td>
<td>-0.001 (0.009)</td>
</tr>
<tr>
<td>Cut 1</td>
<td>2.289*** (0.401)</td>
</tr>
<tr>
<td>Cut 2</td>
<td>3.033*** (0.419)</td>
</tr>
<tr>
<td>Cut 3</td>
<td>4.047*** (0.459)</td>
</tr>
<tr>
<td>Cut 4</td>
<td>4.999*** (0.514)</td>
</tr>
<tr>
<td>rho</td>
<td>0.774*** (0.042)</td>
</tr>
<tr>
<td>Joint test of MW and wage*MW</td>
<td>$\chi^2(2)=1.86$ P=0.394</td>
</tr>
</tbody>
</table>

*Significantly different from 0 at the 10% level, two-tailed test.
**Significantly different from 0 at the 5% level, two-tailed test.
***Significantly different from 0 at the 1% level, two-tailed test.
Standard errors are in parentheses.

Table 16: Random Effects Ordered Probit for the Effects on Effort of the Minimum Wage within and Ongoing Labor Market: Experiment 2
<table>
<thead>
<tr>
<th>Effort Range</th>
<th>Wage=40</th>
<th>Wage=60</th>
<th>Wage=80</th>
<th>Wage=100</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-19</td>
<td>0.083</td>
<td>0.086</td>
<td>0.034</td>
<td>0.005</td>
</tr>
<tr>
<td></td>
<td>(0.094)</td>
<td>(0.072)</td>
<td>(0.033)</td>
<td>(0.008)</td>
</tr>
<tr>
<td>20-39</td>
<td>-0.037</td>
<td>-0.013</td>
<td>0.047</td>
<td>0.020</td>
</tr>
<tr>
<td></td>
<td>(0.050)</td>
<td>(0.027)</td>
<td>(0.038)</td>
<td>(0.024)</td>
</tr>
<tr>
<td>40-59</td>
<td>-0.038</td>
<td>-0.050</td>
<td>0.028</td>
<td>0.066</td>
</tr>
<tr>
<td></td>
<td>(0.039)</td>
<td>(0.044)</td>
<td>(0.054)</td>
<td>(0.072)</td>
</tr>
<tr>
<td>60-79</td>
<td>-0.008</td>
<td>-0.039</td>
<td>-0.052</td>
<td>0.029</td>
</tr>
<tr>
<td></td>
<td>(0.007)</td>
<td>(0.031)</td>
<td>(0.042)</td>
<td>(0.072)</td>
</tr>
<tr>
<td>80-100</td>
<td>-0.001</td>
<td>-0.010</td>
<td>-0.057</td>
<td>-0.120</td>
</tr>
<tr>
<td></td>
<td>(0.001)</td>
<td>(0.011)</td>
<td>(0.064)</td>
<td>(0.145)</td>
</tr>
</tbody>
</table>

*Significantly different from 0 at the 10% level, two tailed test.
**Significantly different from 0 at the 5% level, two-tailed test.
***Significantly different from 0 at the 1% level, two-tailed test.
Standard errors are in parentheses.

Table 17: Marginal Effects of the Minimum Wage for Random Effects Ordered Probit within an Ongoing Labor Market: Experiment 2
APPENDIX C

MINIMUM WAGE EXPERIMENTAL MATERIALS
This Appendix contains the experimental materials that were used for Experiment 1. Materials were distributed to all participants regarding general information and instructions, payoff functions and practice exercises. The Employee and Manager Record Sheets were distributed only to the participants of that type. Figure 15 shows the Experimenter Matching and Manager Record Sheet which contained the randomized pairs corresponding to each period, and Figure 16 shows the record sheet that was used to record and assign the employee-manager pairs. These materials were modified slightly to account for differences in the number of periods in the session and the payoff functions were changed in the materials for Experiment 2.
General Information

Thank you for being part of our research. You will be participating in a study of labor markets. If you read these instructions carefully you may earn a significant sum of money.

Each of you will be randomly assigned to one of two groups: “Managers” and “Employees.” Whether you are a manager or employee is noted at the top of your record sheet.

Each market period will have three stages:

- **Stage 1:** Each manager assigns a wage to an employee. The manager records the wage assigned to his or her employee on the record sheet provided. A monitor will record the wage chosen by each manager.

- **Stage 2:** The monitor will record (on the employee’s record sheet) the wages received by the employee. The employee then chooses the amount of work to provide.

- **Stage 3:** The monitor informs each manager about the amount of work provided by his or her employee.

As an employee, your income depends on the wage received less the cost of the amount of work provided. As a manager, your income depends on the wages paid and the amount of work provided. Details for computing employee and managers earnings will be provided.

Please record (on your record sheet) the wage in each period and the amount of work chosen. After recording this information you will then calculate the income you have earned. Once everyone has calculated and recorded their income, the first period of the labor market will be over. Over the course of the session, you will not be matched more than twice with the same person and you will never be paired with the same person for two consecutive periods. In addition, you will not know with whom you have been matched in any of the periods. Your total income for participating in this market will be the sum of the earnings in each of the fifteen periods.
How the Labor Market Works

1. At the beginning of each period we will open the labor market. In Stage 1 each manager chooses a wage for his or her employee and records the wage on the record sheet. Employees must accept the wage they have been assigned, forming a labor contract with the manager.

2. A monitor will write the wage given to each employee on his or her record sheet.

3. No manager will know the identity of the employee with whom s/he has been paired, and no employee will know the identity of the manager.

4. After all wages have been communicated to each employee Stage 2 begins. Employees choose an amount of work to provide and record it on the record sheet.

5. In Stage 3 a monitor will write the amount of work provided on the manager’s record sheet. Both managers and employees can then compute the earnings for the period. Employees should not tell anyone what amount of work they have chosen and managers should not tell anyone about the work level of their employees.
How Do Employees Calculate Their Income in Each Period?

1. From the wage received you must subtract out the costs of the amount of work you provide.

2. You determine the amount of work by choosing a number between 1 and 10 from the schedule below. The lowest amount of work you can choose is 1, 2 is a slightly higher amount, and so on up to 10, which is the highest amount.

3. The higher the amount of work that you choose, the better it is for the manager. That is, the higher the number you choose the higher the manager’s income.

4. The higher the amount of work you choose, the higher your work-related costs. You can see how these costs are related to amount of work by looking at the schedule below.

<table>
<thead>
<tr>
<th>Amount of Work</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
<th>10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost</td>
<td>0</td>
<td>1</td>
<td>2</td>
<td>4</td>
<td>6</td>
<td>8</td>
<td>10</td>
<td>13</td>
<td>16</td>
<td>20</td>
</tr>
</tbody>
</table>

5. Your income in Experimental Dollars will be determined by the following formula:

\[
\text{Income} = \text{Wage} - \text{Cost of Amount of Work Provided}
\]

How Do Managers Calculate their Income in Each Period?

1. Each manager begins each period with 100 “offer notes” from which to pay wages to an employee. When a manager chooses a wage, those offer notes are given to the employee. The remaining offer notes are converted into Manager Income according to the following formula:

\[
\text{Manager’s Income} = (100 - \text{wage paid}) \times 0.2 + (8 \times \text{Amount of Work Provided by the Employee})
\]
**Practice Exercises**

**Employee's Income = Wage – Cost of Amount of Work Provided**

**Manager’s Income = ((100 – wage) \(\times\) 0.2)+ (8 \(\times\) Amount of Work Provided by the Employee)**

<table>
<thead>
<tr>
<th>Amount of Work</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
<th>10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost</td>
<td>0</td>
<td>1</td>
<td>2</td>
<td>4</td>
<td>6</td>
<td>8</td>
<td>10</td>
<td>13</td>
<td>16</td>
<td>20</td>
</tr>
</tbody>
</table>

1. Assume that a manager, who has 100 offer notes, assigns a wage of 80 experimental dollars to the employee. At the second stage of the period, the employee chooses an amount of work of 2.

   What is the income for the employee and for the manager?
   
   Employee’s Income =__________ Experimental dollars
   
   Manager’s Income =__________ Experimental dollars

2. Assume again that a manager assigns a wage of 80 to the employee. At the second stage of the period, the employee chooses an amount of work of 5.

   What is the income for the employee and for the manager?
   
   Employee’s Income =__________ Experimental dollars
   
   Manager’s Income =__________ Experimental dollars

3. Assume that a manager, who has 100 offer notes, assigns a wage of 20 experimental dollars to the employee. At the second stage of the period, the employee chooses an amount of work of 8.

   What is the income for the employee and for the manager?
   
   Employee’s Income =__________ Experimental dollars
   
   Manager’s Income =__________ Experimental dollars
4. Assume again that a manager assigns a wage of 20 to the employee. At the second stage of the period, the employee chooses an amount of work of 1.

What is the income for the employee and for the manager?

Employee’s Income = __________ Experimental dollars
Manager’s Income = __________ Experimental dollars
During the experiment your income will be calculated in “Experimental dollars,” which will be converted into real dollars at the rate of:

25 Experimental Dollars = $1

In addition, you will receive a $5 payment for showing up for the experiment on time.

There will be a total of 15 market periods. Your total earnings for participating in the experiment will be the sum of your earnings in each of the fifteen market periods plus the $5 participation fee. You will be paid privately at the conclusion of the experiment.

Are there any questions?
EMPLOYEE RECORD SHEET

ID#__________

Employee’s Income = Wage – Cost of Amount of Work Provided

<table>
<thead>
<tr>
<th>Amount of Work</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
<th>10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost</td>
<td>0</td>
<td>1</td>
<td>2</td>
<td>4</td>
<td>6</td>
<td>8</td>
<td>10</td>
<td>13</td>
<td>16</td>
<td>20</td>
</tr>
</tbody>
</table>

Period 1
Your Wage ____________  Your Work Amount _____________
Your earnings for Period 1 __________

Period 2
Your Wage ____________  Your Work Amount _____________
Your earnings for Period 2 __________

Period 3
Your Wage ____________  Your Work Amount _____________
Your earnings for Period 3 __________

Period 4
Your Wage ____________  Your Work Amount _____________
Your earnings for Period 4 __________

Period 5
Your Wage ____________  Your Work Amount _____________
Your earnings for Period 5 __________

Period 6
Your Wage ____________  Your Work Amount _____________
Your earnings for Period 6 __________

Period 7
Your Wage ____________  Your Work Amount _____________
Your earnings for Period 7 __________
Employee’s Income = Wage – Cost of Amount of Work Provided

ID#____________

<table>
<thead>
<tr>
<th>Amount of Work</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
<th>10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost</td>
<td>0</td>
<td>1</td>
<td>2</td>
<td>4</td>
<td>6</td>
<td>8</td>
<td>10</td>
<td>13</td>
<td>16</td>
<td>20</td>
</tr>
</tbody>
</table>

Period 8
Your Wage ____________  Your Work Amount _____________

Your earnings for Period 8 __________

Period 9
Your Wage ____________  Your Work Amount _____________

Your earnings for Period 9 __________

Period 10
Your Wage ____________  Your Work Amount _____________

Your earnings for Period 10 __________

Period 11
Your Wage ____________  Your Work Amount _____________

Your earnings for Period 11 __________

Period 12
Your Wage ____________  Your Work Amount _____________

Your earnings for Period 12 __________

Period 13
Your Wage ____________  Your Work Amount _____________

Your earnings for Period 13 __________

Period 14
Your Wage ____________  Your Work Amount _____________

Your earnings for Period 14 __________

Period 15
Your Wage ____________  Your Work Amount _____________

Your earnings for Period 15 __________
Manager's Income = \((100 - \text{wage}) \times 0.2\) + \((8 \times \text{Amount of Work Provided by the Employee})\)

**Period 1**
Wage Paid ____________  Amount of Work ____________

Your earnings for Period 1 __________

**Period 2**
Wage Paid ____________  Amount of Work ____________

Your earnings for Period 2 __________

**Period 3**
Wage Paid ____________  Amount of Work ____________

Your earnings for Period 3 __________

**Period 4**
Wage Paid ____________  Amount of Work ____________

Your earnings for Period 4 __________

**Period 5**
Wage Paid ____________  Amount of Work ____________

Your earnings for Period 5 __________

**Period 6**
Wage Paid ____________  Amount of Work ____________

Your earnings for Period 6 __________

**Period 7**
Wage Paid ____________  Amount of Work ____________

Your earnings for Period 7 __________
Manager's Income = ((100 – wage) X 0.2)+ (8 X Amount of Work Provided by the Employee)

<table>
<thead>
<tr>
<th>Period 8</th>
<th>Wage Paid</th>
<th>Amount of Work</th>
<th>Your earnings for Period 8</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Period 9</th>
<th>Wage Paid</th>
<th>Amount of Work</th>
<th>Your earnings for Period 9</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Period 10</th>
<th>Wage Paid</th>
<th>Amount of Work</th>
<th>Your earnings for Period 10</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Period 11</th>
<th>Wage Paid</th>
<th>Amount of Work</th>
<th>Your earnings for Period 11</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Period 12</th>
<th>Wage Paid</th>
<th>Amount of Work</th>
<th>Your earnings for Period 12</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Period 13</th>
<th>Wage Paid</th>
<th>Amount of Work</th>
<th>Your earnings for Period 13</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Period 14</th>
<th>Wage Paid</th>
<th>Amount of Work</th>
<th>Your earnings for Period 14</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Period 15</th>
<th>Wage Paid</th>
<th>Amount of Work</th>
<th>Your earnings for Period 15</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### MANAGER SHEET

| Period | M1 | E# | M2 | E# | M3 | E# | M4 | E# | M5 | E# | M6 | E# | M7 | E# | M8 | E# | M9 | E# | M10 | E# |
|--------|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|----|
| 1      | 10 | 9  | 8  | 7  | 6  | 5  | 4  | 3  | 2  | 1  | 10 | 1  | 1  | 1  | 1  | 1  | 1  | 10 | 1  |
| 2      | 9  | 8  | 7  | 6  | 5  | 4  | 3  | 2  | 1  | 1  | 10 | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 10 |
| 3      | 8  | 7  | 6  | 5  | 4  | 3  | 2  | 1  | 1  | 1  | 10 | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 10 |
| 4      | 7  | 6  | 5  | 4  | 3  | 2  | 1  | 1  | 1  | 1  | 10 | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 10 |
| 5      | 6  | 5  | 4  | 3  | 2  | 1  | 1  | 1  | 1  | 1  | 10 | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 10 |
| 6      | 5  | 4  | 3  | 2  | 1  | 1  | 1  | 1  | 1  | 1  | 10 | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 10 |
| 7      | 4  | 3  | 2  | 1  | 1  | 10 | 9  | 8  | 7  | 6  | 5  | 4  | 3  | 2  | 1  | 1  | 1  | 1  | 10 |
| 8      | 3  | 2  | 1  | 1  | 10 | 9  | 8  | 7  | 6  | 5  | 4  | 3  | 2  | 1  | 1  | 1  | 1  | 1  | 10 |
| 9      | 2  | 1  | 10 | 9  | 8  | 7  | 6  | 5  | 4  | 3  | 2  | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 10 |
| 10     | 1  | 10 | 9  | 8  | 7  | 6  | 5  | 4  | 3  | 2  | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 10 |
| 11     | 10 | 9  | 8  | 7  | 6  | 5  | 4  | 3  | 2  | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 10 |
| 12     | 9  | 8  | 7  | 6  | 5  | 4  | 3  | 2  | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 10 |
| 13     | 8  | 7  | 6  | 5  | 4  | 3  | 2  | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 10 |
| 14     | 7  | 6  | 5  | 4  | 3  | 2  | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 10 |
| 15     | 6  | 5  | 4  | 3  | 2  | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 1  | 10 |

Figure 14: Experimenter Matching and Manager Record Sheet

### EMPLOYEE SHEET

<table>
<thead>
<tr>
<th>Period</th>
<th>E1</th>
<th>E2</th>
<th>E3</th>
<th>E4</th>
<th>E5</th>
<th>E6</th>
<th>E7</th>
<th>E8</th>
<th>E9</th>
<th>E10</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>W</td>
<td>E</td>
<td>W</td>
<td>E</td>
<td>W</td>
<td>E</td>
<td>W</td>
<td>E</td>
<td>W</td>
<td>E</td>
</tr>
<tr>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
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<td>3</td>
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<tr>
<td>5</td>
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<td>6</td>
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<tr>
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<td>9</td>
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<td></td>
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<tr>
<td>13</td>
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<tr>
<td>14</td>
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<td></td>
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<tr>
<td>15</td>
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<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Figure 15: Experimenter Employee Record Sheet

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APPENDIX D

SUBSIDY FIGURES
Figure 16: Average Wage and Effort by Period: Subsidy Experiment

Figure 17: Kernel Regressions of Effort as a Function of Wages in the Periods (4-10) with a Subsidy
Figure 18: Kernel Regressions of Effort Provided by Regular Workers as a Function of Wages: Before and During the Subsidy
APPENDIX E

SUBSIDY STATISTICAL TABLES
<table>
<thead>
<tr>
<th></th>
<th>All periods</th>
<th>Periods 1-3</th>
<th>Periods 4-10</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Wage</strong></td>
<td>53.1</td>
<td>57.56</td>
<td>51.19</td>
</tr>
<tr>
<td></td>
<td>(2.30)</td>
<td>(3.44)</td>
<td>(2.93)</td>
</tr>
<tr>
<td>n=130</td>
<td></td>
<td>n=39</td>
<td>n=91</td>
</tr>
<tr>
<td><strong>Effort Regular Workers</strong></td>
<td>19.18</td>
<td>24.21</td>
<td>17.02</td>
</tr>
<tr>
<td></td>
<td>(2.23)</td>
<td>(3.50)</td>
<td>(2.78)</td>
</tr>
<tr>
<td>n=130</td>
<td></td>
<td>n=39</td>
<td>n=91</td>
</tr>
<tr>
<td><strong>Effort Unemployed Workers</strong></td>
<td>18.88</td>
<td>18.88</td>
<td>18.88</td>
</tr>
<tr>
<td></td>
<td>(2.11)</td>
<td></td>
<td>(2.11)</td>
</tr>
<tr>
<td>n=91</td>
<td></td>
<td></td>
<td>n=91</td>
</tr>
</tbody>
</table>

Standard errors at the mean are in parentheses.

Table 18: Mean Wage and Effort Provision: Subsidy Experiment

<table>
<thead>
<tr>
<th></th>
<th>Random Effects Tobit</th>
<th>Random Effects Tobit</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Wage</strong></td>
<td>0.545*** (0.067)</td>
<td>0.522*** (0.090)</td>
</tr>
<tr>
<td><strong>Regular Worker</strong></td>
<td>-8.570 (7.693)</td>
<td>-11.315 (10.623)</td>
</tr>
<tr>
<td><strong>Regular Worker*Wage</strong></td>
<td></td>
<td>0.051 (0.135)</td>
</tr>
<tr>
<td><strong>Constant</strong></td>
<td>-11.852* (6.038)</td>
<td>-10.646 (6.807)</td>
</tr>
<tr>
<td><strong>Observations</strong></td>
<td>N=182</td>
<td>N=182</td>
</tr>
<tr>
<td><strong>Joint test of Regular Employee and Regular Employee*Wage</strong></td>
<td>X²(2) = 1.35</td>
<td>P = 0.51</td>
</tr>
</tbody>
</table>

Regular Worker = 1 if the employee is an unsubsidized worker; 0 if the employee is subsidized.
*Significantly different from 0 at the 10% level, two tailed test.
**Significantly different from 0 at the 5% level, two-tailed test.
***Significantly different from 0 at the 1% level, two-tailed test.
Standard errors are in parentheses.

Table 19: Random Effects Tobit Regressions on Effort for last 7 periods: Subsidy Experiment
### Table 20: Random Effects Tobit Regressions on Effort for Employed Workers periods 1-10: Subsidy Experiment

<table>
<thead>
<tr>
<th>Dependent Variable is Effort</th>
<th>Random Effects Tobit</th>
<th>Random Effects Tobit</th>
<th>Random Effects Tobit</th>
<th>Random Effects Tobit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wage</td>
<td>0.623*** (0.104)</td>
<td>0.611*** (0.103)</td>
<td>0.685*** (0.201)</td>
<td>1.336*** (0.417)</td>
</tr>
<tr>
<td>Subsidy period</td>
<td>-12.236** (4.894)</td>
<td>-6.709 (13.725)</td>
<td>-10.903** (4.856)</td>
<td>32.114 (29.142)</td>
</tr>
<tr>
<td>Subsidy period*Wage</td>
<td>-0.096 (0.224)</td>
<td>-0.096 (0.224)</td>
<td>-0.096 (0.224)</td>
<td>-1.488 (1.083)</td>
</tr>
<tr>
<td>Wage²</td>
<td></td>
<td>-0.007* (0.004)</td>
<td>-0.016** (0.008)</td>
<td></td>
</tr>
<tr>
<td>Wage²*Subsidy period</td>
<td></td>
<td></td>
<td>0.011 (0.009)</td>
<td></td>
</tr>
<tr>
<td>Constant</td>
<td>-20.567*** (7.397)</td>
<td>-11.758 (8.072)</td>
<td>-16.037*** (12.759)</td>
<td>-29.105** (12.738)</td>
</tr>
<tr>
<td>Observations</td>
<td>N=130</td>
<td>N=130</td>
<td>N=130</td>
<td>N=130</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Joint test of Subsidy period and Subsidy period*Wage</th>
<th>Joint test of Subsidy period, Subsidy period<em>Wage, and subsidy period</em>wage²</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$X^2(2) = 6.45$</td>
<td>$X^2(3) = 7.44$</td>
</tr>
<tr>
<td></td>
<td>$P = 0.040**$</td>
<td>$P = 0.059*$</td>
</tr>
</tbody>
</table>

Subsidy period = 1 if the subsidy is in place for the period; 0 otherwise.

*Significantly different from 0 at the 10% level, two tailed test.
**Significantly different from 0 at the 5% level, two-tailed test.
***Significantly different from 0 at the 1% level, two-tailed test.

Standard errors are in parentheses.
<table>
<thead>
<tr>
<th>Effort</th>
<th>All Employees</th>
<th>Regular Employees Only</th>
<th>Subsidized Employees Only</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wage</td>
<td>0.570***</td>
<td>0.623***</td>
<td>0.517***</td>
</tr>
<tr>
<td></td>
<td>(0.063)</td>
<td>(0.103)</td>
<td>(0.068)</td>
</tr>
<tr>
<td>Offer1</td>
<td>5.236</td>
<td>17.407*</td>
<td>-2.997</td>
</tr>
<tr>
<td></td>
<td>(5.851)</td>
<td>(10.188)</td>
<td>(5.900)</td>
</tr>
<tr>
<td>Offer2</td>
<td>4.742</td>
<td>17.281*</td>
<td>-4.589</td>
</tr>
<tr>
<td></td>
<td>(5.872)</td>
<td>(10.317)</td>
<td>(5.848)</td>
</tr>
<tr>
<td>Offer3</td>
<td>6.856</td>
<td>20.126**</td>
<td>-2.634</td>
</tr>
<tr>
<td></td>
<td>(5.864)</td>
<td>(10.276)</td>
<td>(5.869)</td>
</tr>
<tr>
<td>Offer4</td>
<td>-3.911</td>
<td>6.333</td>
<td>-10.438*</td>
</tr>
<tr>
<td></td>
<td>(6.043)</td>
<td>(10.596)</td>
<td>(6.034)</td>
</tr>
<tr>
<td>Offer6</td>
<td>-1.088</td>
<td>10.601</td>
<td>-9.550</td>
</tr>
<tr>
<td></td>
<td>(6.113)</td>
<td>(10.722)</td>
<td>(6.112)</td>
</tr>
<tr>
<td>Offer7</td>
<td>-4.123</td>
<td>7.021</td>
<td>-10.545*</td>
</tr>
<tr>
<td></td>
<td>(6.080)</td>
<td>(10.596)</td>
<td>(6.144)</td>
</tr>
<tr>
<td>Offer8</td>
<td>-0.445</td>
<td>8.808</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(7.930)</td>
<td>(10.813)</td>
<td></td>
</tr>
<tr>
<td>Offer9</td>
<td>-0.715</td>
<td>9.693</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(7.739)</td>
<td>(10.484)</td>
<td></td>
</tr>
<tr>
<td>Offer10</td>
<td>-8.986</td>
<td>0.352</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(7.739)</td>
<td>(10.370)</td>
<td></td>
</tr>
<tr>
<td>Regular</td>
<td>-2.901</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Worker</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(6.875)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Constant</td>
<td>-14.488***</td>
<td>-30.674***</td>
<td>-4.139</td>
</tr>
<tr>
<td></td>
<td>(6.875)</td>
<td>(10.370)</td>
<td>(6.150)</td>
</tr>
<tr>
<td>N=</td>
<td>221</td>
<td>130</td>
<td>91</td>
</tr>
</tbody>
</table>

Note: The Offer1 variable is a dummy =1 for the first offer received by the employee, and zero otherwise. All other Offer variables work in the same way and correspond to the offer number. Also note that the first offer occurs for regular employees in period one, and for the previously unemployed in period 4. The dummy for the fifth offer received is excluded for identification. Standard errors are in parentheses.

Table 21: Random Effects Tobit Regressions on Effort: Subsidy Experiment
### Table 22: Random Effects Tobit Regressions on Wage for Managers periods 1-10:

<table>
<thead>
<tr>
<th>Dependent Variable is Wage</th>
<th>Random Effects Tobit</th>
<th>Random Effects Tobit</th>
<th>Random Effects Tobit</th>
<th>Random Effects Tobit</th>
<th>Random Effects Tobit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lagged Wage</td>
<td>0.350*** (0.115)</td>
<td></td>
<td></td>
<td>0.257** (0.118)</td>
<td>0.256** (0.122)</td>
</tr>
<tr>
<td>Lagged Average Effort</td>
<td>0.352*** (0.114)</td>
<td>0.341*** (0.116)</td>
<td>0.252** (0.122)</td>
<td>0.252** (0.122)</td>
<td></td>
</tr>
<tr>
<td>Subsidy Period</td>
<td>-7.331* (4.089)</td>
<td>-2.688 (4.674)</td>
<td>-0.223 (4.846)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Constant</td>
<td>33.745*** (7.037)</td>
<td>44.120*** (6.343)</td>
<td>55.587*** (5.838)</td>
<td>46.400*** (7.595)</td>
<td>33.514*** (6.817)</td>
</tr>
<tr>
<td>Observations</td>
<td>N=117</td>
<td>N=117</td>
<td>N=130</td>
<td>N=117</td>
<td>N=117</td>
</tr>
</tbody>
</table>

Subsidy periods = 1 if the subsidy is in place for the period; 0 otherwise.
Lagged Average Effort is the average of the effort provided to the manager in the prior period.
*Significantly different from 0 at the 10% level, two tailed test.
**Significantly different from 0 at the 5% level, two-tailed test.
***Significantly different from 0 at the 1% level, two-tailed test.
Standard errors are in parentheses.
APPENDIX F

SUBSIDY EXPERIMENTAL MATERIALS
This Appendix contains the materials from the Subsidy Experiment described in Chapter 3. Materials were distributed to all participants regarding general information and instructions, payoff functions and practice exercises. The Employee and Manager Record Sheets were distributed only to the participants of that type. The announcement of the subsidy sheet and the new record sheet for the managers was distributed after the third period. Figure 19 shows the Experimenter Matching and Manager Record Sheet which contained the randomized pairs corresponding to each period, and Figure 20 shows the record sheet that was used to record and assign wages and effort between employees and managers.
General Information

Thank you for being part of our research. You will be participating in a study of labor markets. If you read these instructions carefully you may earn a significant sum of money.

Each of you will be randomly assigned to one of two groups: “Managers” and “Employees.” Whether you are a manager or employee is noted at the top of your record sheet.

Each market period will have three stages:

- **Stage 1:** The managers assign wages to the employees. The manager records the wage assigned to his or her employee(s) on the record sheet provided. A monitor will record the wage chosen by each manager.

- **Stage 2:** The monitor will record (on the employee’s record sheet) the wages received by the employee. The employee then chooses the amount of work to provide.

- **Stage 3:** The monitor informs each manager about the amount of work provided by his or her employee(s).

As an employee, your income depends on the wage received and the amount of work you provide. As a manager, your income depends on the wages paid and the amount of work provided to you. Details for computing employee and manager earnings will be provided.

Please record (on your record sheet) the wage in each period and the amount of work chosen. After recording this information you will then calculate the income you have earned. Once everyone has calculated and recorded their income, the first period of the labor market will be over. Over the course of the session, you will not be matched with the same person for two consecutive periods and will not be matched with the same person more than twice in total. In addition, you will not know with whom you have been matched in any of the periods. Your total income for participating in this market will be the sum of the earnings in each of the ten periods.
How the Labor Market Works

1. At the beginning of each period we will open the labor market. In Stage 1 each manager chooses a wage for his or her employee(s) and records the wage on the record sheet. Employees receiving a wage must accept the wage they have been assigned, forming a labor contract with the manager. Some workers will not receive a wage meaning that they are unemployed. Workers who do not receive a wage will receive a fixed unemployment payment. Workers who will receive wages (versus those who are unemployed) are determined randomly at the start of today’s session.

2. A monitor will write the wage given to each employee on his or her record sheet. The monitor will write a “U” on the record sheet for all workers who are unemployed.

3. **No manager will know the identity of the employees with whom s/he has been paired, and no employee will know the identity of the manager.**

4. After all wages have been communicated to each employee Stage 2 begins. Employees who have received a wage choose an amount of work to provide and record it on the record sheet.

5. In Stage 3 a monitor will write the amount of work provided on the manager’s record sheet. Both managers and employees can then compute the earnings for the period. Employees should not tell anyone what amount of work they have chosen and managers should not tell anyone about the work level of their employees.
How Do Employees Calculate Their Income in Each Period?

1. Employee income in Experimental Dollars will be determined by the following formula:

   **Employee Income:**

   \[
   \begin{align*}
   \text{If Employed} & = 100 - \text{Amount of Work Provided} + (\text{Wage} \times 5) \\
   \text{If Unemployed} & = 70
   \end{align*}
   \]

2. If you receive a wage, you determine the amount of work by choosing a number from 0 to 100. The lowest amount of work you can choose is 0, 1 is a slightly higher amount, and so on up to 100, which is the highest amount. If you are unemployed, you do not choose an amount of work and you will receive an income of 70.

3. The higher the amount of work that you choose, the better it is for the manager. That is, the higher the number you choose the higher the manager’s income.

4. The higher the amount of work you choose, the higher your work-related costs.
**How Do Managers Calculate their Income in Each Period?**

1. Manager income in Experimental Dollars will be determined by the following formula for employed workers:

   \[
   \text{Manager Income} = 100 - \text{Wage} + (\text{Amount of Work Provided} \times 5)
   \]

2. You determine the wage by choosing a number from 0 to 100. The lowest wage you can choose is 0, 1 is a slightly higher amount, and so on up to 100, which is the highest amount.

3. The higher the wage that you choose, the better it is for the employee. That is, the higher the number you choose the higher the employee’s income.

4. The higher the wage you choose, the higher your costs.
Practice Exercises

Employee Income = 100 – Amount of Work Provided + (Wage * 5)
Manager Income = 100 – Wage + (Amount of Work Provided * 5)

1. Assume that a manager assigns a wage of 80 experimental dollars to the employee. At the second stage of the period, the employee chooses an amount of work of 20.

What is the income for the employee and for the manager?

Employee’s Income = __________ Experimental dollars
Manager’s Income = __________ Experimental dollars

2. Assume that a manager assigns a wage of 80 to the employee. At the second stage of the period, the employee chooses an amount of work of 90.

What is the income for the employee and for the manager?

Employee’s Income = __________ Experimental dollars
Manager’s Income = __________ Experimental dollars

3. Assume that a manager assigns a wage of 30 experimental dollars to the employee. At the second stage of the period, the employee chooses an amount of work of 80.

What is the income for the employee and for the manager?

Employee’s Income = __________ Experimental dollars
Manager’s Income = __________ Experimental dollars

4. Assume that a manager assigns a wage of 30 to the employee. At the second stage of the period, the employee chooses an amount of work of 10.

What is the income for the employee and for the manager?

Employee’s Income = __________ Experimental dollars
Manager’s Income = __________ Experimental dollars
During the experiment your income will be calculated in “Experimental dollars,” which will be converted into real dollars at the rate of:

\[
250 \text{ Experimental Dollars} = \$1
\]

In addition, you will receive a $6 payment for showing up for the experiment on time.

There will be a total of 10 market periods. Workers who are unemployed will remain unemployed for the first three (3) market periods after which there will be opportunities for them to work.

Your total earnings for participating in the experiment will be the sum of your earnings in each of the ten market periods plus the $6 participation fee. You will be paid privately at the conclusion of the experiment.

Are there any questions?
EMPLOYEE RECORD SHEET

Employee Income = 100 – Amount of Work Provided + (Wage * 5)

Period 1
Your Wage ____________  Your Work Amount ____________

Your earnings for Period 1 __________

Period 2
Your Wage ____________  Your Work Amount ____________

Your earnings for Period 2 __________

Period 3
Your Wage ____________  Your Work Amount ____________

Your earnings for Period 3 __________

Period 4
Your Wage ____________  Your Work Amount ____________

Your earnings for Period 4 __________

Period 5
Your Wage ____________  Your Work Amount ____________

Your earnings for Period 5 __________

Period 6
Your Wage ____________  Your Work Amount ____________

Your earnings for Period 6 __________

Period 7
Your Wage ____________  Your Work Amount ____________

Your earnings for Period 7 __________
ID#____________

Employee Income = 100 – Amount of Work Provided + (Wage * 5)

Period 8
Your Wage ____________  Your Work Amount ____________

Your earnings for Period 8 __________

Period 9
Your Wage ____________  Your Work Amount ____________

Your earnings for Period 9 __________

Period 10
Your Wage ____________  Your Work Amount ____________

Your earnings for Period 10 __________
Manager Income = 100 – Wage + (Amount of Work Provided * 5)

**Period 1**
Wage Paid ____________  Amount of Work ____________

Your earnings for Period 1 __________

**Period 2**
Wage Paid ____________  Amount of Work ____________

Your earnings for Period 2 __________

**Period 3**
Wage Paid ____________  Amount of Work ____________

Your earnings for Period 3 __________
Announcement for the subsidy:

Managers will now have the opportunity to employ the previously unemployed under a subsidized wage structure that applies only to the previously unemployed. It is like a program to help relieve unemployment. Now managers can employ two employees, one previously employed worker and one previously unemployed worker.

Manager’s Income:

The structure of manager’s income for the subsidized workers will be:

Manager Income (for subsidized worker) = 100 – ½ Wage + (amount of work)*5.

As with the workers you have been hiring previous to this, you determine the wage by choosing a number from 0 to 100. The higher the wage that you choose, the better it is for the employee. The higher the wage you choose, the higher your costs, but since wages for the previously unemployed workers are subsidized it only costs managers half as much as before.

The structure of the manager’s earnings for the previously employed workers remains the same as before.

Manager Income (for regular worker) = 100 – Wage + (amount of work)*5.

The total manager’s income for each period will be the sum of the income from each of the two employees.

Manager Income = Subsidized Worker Income + Regular Worker Income

The only restriction is that managers must offer the same wage to both workers.

Employee’s Income:

Income for employees will be calculated just as before, but now no one will be unemployed.

Employee income = 100 – amount of work + Wage*5

Just as before, you determine the amount of work by choosing a number from 0 to 100. The higher the amount of work that you choose, the better it is for the manager. The higher the amount of work you choose, the higher your work-related costs.

Note that this income schedule is the same for both previously employed and previously unemployed workers.
Practice Exercises (part 2)

Employee Income = 100 – Amount of Work Provided + (Wage * 5)

Manager Income:
From Regular Employee = 100 – Wage + (Amount of Work Provided * 5)
From Subsidized Employee = 100 – ½ Wage + (Amount of Work Provided*5)

1. Assume that a manager assigns a wage of 80 experimental dollars to the employees. At the second stage of the period, each employee chooses an amount of work of 20.

What is the income for the employee and for the manager?

Employee’s Income = _________ Experimental dollars
Manager’s Income
From regular employee = _________ Experimental dollars
From subsidized employee= _________ Experimental dollars
Total Manager’s Income = _________ Experimental dollars

2. Assume that a manager assigns a wage of 80 experimental dollars to the employees. At the second stage of the period, each employee chooses an amount of work of 90.

What is the income for the employee and for the manager?

Employee’s Income = _________ Experimental dollars
Manager’s Income
From regular employee = _________ Experimental dollars
From subsidized employee= _________ Experimental dollars
Total Manager’s Income = _________ Experimental dollars
3. Assume that a manager assigns a wage of 30 experimental dollars to the employees. At the second stage of the period, each employee chooses an amount of work of 80.

What is the income for the employee and for the manager?

Employee’s Income =__________ Experimental dollars

Manager’s Income

From regular employee =__________ Experimental dollars

From subsidized employee=__________ Experimental dollars

Total Manager’s Income =__________ Experimental dollars

4. Assume that a manager assigns a wage of 30 experimental dollars to the employees. At the second stage of the period, each employee chooses an amount of work of 10.

What is the income for the employee and for the manager?

Employee’s Income =__________ Experimental dollars

Manager’s Income

From regular employee =__________ Experimental dollars

From subsidized employee=__________ Experimental dollars

Total Manager’s Income =__________ Experimental dollars
MANAGER RECORD SHEET

Manager Income:

From Regular Employee = 100 – Wage + (Amount of Work Provided * 5)
From Subsidized Employee = 100 – ½ Wage + (Amount of Work Provided*5)

Note: The wage for Regular and Subsidized workers must be equal.

Period 4
Wage Paid ____________

Work amount for Regular employee_____________

Work amount for Subsidized employee __________

Earnings for Period 4 Regular Employee__________

Earnings for Period 4 Subsidized Employee__________

Period 5
Wage Paid ____________

Work amount for Regular employee_____________

Work amount for Subsidized employee __________

Earnings for Period 5 Regular Employee__________

Earnings for Period 5 Subsidized Employee__________

Period 6
Wage Paid ____________

Work amount for Regular employee_____________

Work amount for Subsidized employee __________

Earnings for Period 6 Regular Employee__________

Earnings for Period 6 Subsidized Employee__________
MANAGER RECORD SHEET

Manager Income:

From Regular Employee = 100 – Wage + (Amount of Work Provided * 5)
From Subsidized Employee = 100 – ½ Wage + (Amount of Work Provided*5)
Note: The wage for Regular and Subsidized workers must be equal.

Period 7
Wage Paid ____________

Work amount for Regular employee _______________

Work amount for Subsidized employee _____________

Earnings for Period 7 Regular Employee__________

Earnings for Period 7 Subsidized Employee__________

Period 8
Wage Paid ____________

Work amount for Regular employee _______________

Work amount for Subsidized employee _____________

Earnings for Period 8 Regular Employee__________

Earnings for Period 8 Subsidized Employee__________

Period 9
Wage Paid ____________

Work amount for Regular employee _______________

Work amount for Subsidized employee _____________

Earnings for Period 9 Regular Employee__________

Earnings for Period 9 Subsidized Employee__________
MANAGER RECORD SHEET

Manager Income:

From Regular Employee = 100 – Wage + (Amount of Work Provided * 5)
From Subsidized Employee = 100 – \( \frac{1}{2} \) Wage + (Amount of Work Provided\( \times \)5)

Note: The wage for Regular and Subsidized workers must be equal.

Period 10  Wage Paid ____________

Work amount for Regular employee_____________

Work amount for Subsidized employee ___________

Earnings for Period 10 Regular Employee__________

Earnings for Period 10 Subsidized Employee__________
**Figure 19: Experimenter Matching and Manager Record Sheet: Subsidy Experiment**

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**Figure 20: Experimenter Employee Record Sheet: Subsidy Experiment**

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Table 42: Subsidy Data Session 2 (periods 1-3, Before Subsidy)
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Table 43: Subsidy Session 2 (periods 4-10, with Subsidy)


