Morale, Relationships, and Wages: An Experimental Study

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Many labor relations are characterized by discretionary pay components and the possibility of repeated interaction without long term contracts. We implement such a structure in the lab by allowing workers and firms to interact repeatedly for many periods absent a pre-announced final period. In our environment, workers, who are identical (with respect to their productivity) and abundant, choose effort that is costly (to them) and productive (to the firm) and firms cannot commit to fully pay the wage they promised the worker once they observe the worker's effort choice. We observe labor market segmentation emerge endogenously: Some workers and firms enter (long-run) relationships while others remain active in the spot market. Generally, long-run relationships feature good jobs (high worker payoffs in relationships) and spot markets feature bad jobs (low worker payoffs and promise breaking in spot markets). However, in this environment, both market segments are characterized by very high efficiency levels. While the long term relationships are more efficient, however, the increase in effort does not compensate for the increase in sharing. Nevertheless, we find persistent across firm heterogeneity in terms of performance (high profits in spot markets and very short term relationships and low profits in stable long term relationships). We document that firms and workers in the low profit regime are still behaving optimally given their individual histories (and possibly their preferences).