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INCENTIVE CONTRACTS FOR TEAMS: EXPERIMENTAL EVIDENCE*

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Abstract

This paper reports the results of an experiment on incentive contracts for teams. The agents, whose efforts are complementary, are rewarded according to a sharing rule chosen by the principal. Depending on the sharing rule, the agents confront endogenous prisoner's dilemma or stag-hunt environments. Our main findings are as follows. First, we demonstrate that ongoing interaction among team members positively affects the principal's payoff. Greater team cooperation is successfully induced with less generous sharing rules in infinitely-repeated environments. Second, we provide evidence of the positive effects of communication on team cooperation in the absence of ongoing team interaction. Fostering communication among team members does not significantly affect the principal's payoff, suggesting that agents' communication is an imperfect substitute for ongoing team interaction. Third, we show that offering low sharing rules can backfire. The agents are willing to engage in costly punishment (shirking) as retaliation for low offers from the principal. Our findings suggest that offering low sharing rules is perceived by the agents as unkind behavior and hence, triggers negative reciprocity.

KEYWORDS: Moral Hazard in Teams; Prisoner's Dilemma; Stag-Hunt Games; Infinitely-Repeated Games; Communication; Reciprocity; Laboratory Experiments

JEL Categories: C72, C90, D86, K10, L23

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