Incentives and Economics

Let’s start with bit of a theory. What are the forces behind our actions? What makes us work harder, go further and achieve more? Incentive theory suggests that our actions are directed toward gaining rewards. From good grades and rewards motivating us to study hard, to workplace incentives of recognition and esteem to monetary reward fuelling our professional lives, incentives motivate us to work harder, go further and achieve more.

The nature of the reward is often directly correlated to the effort extended to achieving that reward. The scarcity of the reward matters too, we can turn our efforts up when it comes to extra reward, say a performance bonus, compared to recurring reward such as a salary. The incentive space is a micro-economy of its own, with supply and demand, scarcity model, free and fair market - we can apply any of the economic principles to gauge performance of our incentive system. From words of appreciation and formal recognition to physical recognition in form of money, goods or services, we have historically had a broad set of assets we can deploy in our incentive system.

Incentives are an integral part of any economic system

Most economic systems start with two parties, with sufficient **incentives** to interact and exchange value. The more both of the parties benefit from the interaction, the stronger the system gets. In the ideal system, each of the participants would benefit equally, providing enough incentive to continue and evolve the interaction. Let’s call this a virtuous feedback loop. We can assess the virtuous feedback loop in any system, to gauge its efficiency. In barter economy, this is built in - I give you eggs from my chicken in direct exchange for the milk from your cow. Complex financial instruments can be enabling the virtuous feedback loop as well - farmer and a flour mill can enter into contracts such as futures contracts for their crop, options can be traded - ensuring both parties can benefit from the interaction regardless of weather or market condition. Eventually, it is in the best interest of the flour mill that the farmer is successful, and vice versa.

We can rank the interaction on couple of levels

- [x] How transparent is it to both parties?
    - [x] The barter system is super transparent, both parties know exactly what they will get, right away.
        - [ ] Time window is very short (immediate) - this is extremely limiting
        - [x] Cost is low - this is good
        - [x] Risk is low - this is good
- [x] With systems based on complex instruments and long term contracts
    - [ ] Efficiency of the system decreases with multiple friction points
    - [ ] Risk increases
        - [ ] Governance and compliance cost to increase in turn
    - [x] Have a much longer time window, enabling long term relationship

Q: Can we have a new system with the transparency and efficiency of the barter system, but with a efficient long term viability, providing mutual incentive to each party?

A: Yes, by using Smart Contracts and Tokenomics principles, as foundation for the new economic incentive system.

The smart contract codifies and automates all of the future interaction steps and conditions, removing the friction point (i.e. humans executing the steps over time). This increases efficiency and decreases risk and cost.

The tokenomics model directly stipulates the reward. Since this is also a smart contract, the contribution vesting or reward distribution is also automated and fully transparent. Anyone can view the smart contract and and its values.

This new system has all of the following:

- ☑ Scarcity rivalling blue chip commodities such as gold
- ☑ Open and independent market supply and demand
- ☑ Novel experience potential rivalling traditional goods and services - and none of the supply chain issues
- ☑ Transparency and fairness built right in
- ☑ More utility and control than traditional fiscal assets
- ☑ Potential to compose governance and coordination structures, from the ground up
- ☑ Ability to create the virtuous feedback loop, built in
- ☑ Long term enablement

Now let's go back to our incentive system in employee recognition, and apply the above principles

The traditional incentive to nominate achievers is a very mild peer pressure in form of occasional email or a workplace post, plus some downward management pressure to consume the the allocated reward budget. Overall, this is not a great incentive to nominate. Furthermore, even if you do nominate someone, their eventual success doesn't directly reward you as their nominator. Sometimes, you might not even be aware that the recognition has occured - and that someone you have nominated has achieved great things or has gotten a reward! For the nominee, the incentives to compete could also improve. 8 out of 10 surveyed winners still carry their reward points without redeeming them in the company shop.

Imagine if you nominate someone, you become a stake holder in that person - directly vested in their success. Let's express that stake as a token - you get it once you nominate someone. The token appreciates in order to reward you for caring, but if the person you staked your 'trust' into indeed becomes very successful, your stake appreciates more. You get to participate in their success. The tokenomics model in a smart contract drives you to make great nominations, not to game the system. Eventually this new tokenomics could be a component of the overall compensation, as it transparently drives performance and investment in each other's success. Here comes the intersection of digital identity, transparent reputation and tokenomics - the superpower of Web3 powered by blockchain.