Tutorial 9 – Hiring and retention

1. What is meant by the term efficiency wage? Why would a firm pay an efficiency wage? How might promotions tournaments or seniority rules also resolve incentive problems faced by firms?

2. Larry and Harry are both seeking a job with the same firm. Larry has productivity $\theta = L = 1$ and Harry has productivity $\theta = H = 2$. The firm will hire either Larry or Harry and pay a wage of w.

   The firm would like to hire a high productivity worker, but productivity is private information. However, the firm can observe the education level of each candidate.

   Education is easier to obtain for high productivity workers. A worker with productivity θ obtains payoffs S by obtaining education e if they are hired, where

$$S = w - (3 - \theta)e$$

   (a) Suppose the firm offers the following contract:

$$w = \begin{cases} 40 & \text{if} \quad e \geq 15 \\ 20 & \text{if} \quad e < 15 \end{cases}$$

   What will Larry and Harry do? Who will the firm hire?

   (b) Suppose the firm offers the following contract:

$$w = \begin{cases} w_H & \text{if} \quad e \geq e^* \\ w_L & \text{if} \quad e < e^* \end{cases}$$

   What conditions (on w_H, w_L, e^*) are required for a separating equilibrium in which Harry and Larry choose different education?