**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 *θ* = *L* = 1 and Harry has productivity *θ* = *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

1. Suppose the firm offers the following contract:

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

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What conditions (on *wH*, *wL*, e\*) are required for a separating equilibrium in which Harry and Larry choose different education?