

[Managing Intrinsic Motivation in a Long-Run Relationship](#)

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We study a simple model of a long-run relationship between an employer and a worker. Due to contractual incompleteness, the employer is effectively restricted to offering a "spot" wage contract at every period (rather than a more elaborate performance-based payment scheme). If the worker rejects an offer, the two parties are permanently separated. The worker's productivity relies on his "intrinsic motivation". Motivated by ideas in the behavioural-economics literature, we assume that intrinsic motivation is "reference-dependent". Specifically, at any period during the relationship, the worker's productivity plummets if his wage falls below a "reference wage", which we define to be his lagged-expected wage in that period. We assume that the worker's outside option follows a Markov process with i.i.d shocks. We characterize the equilibrium path of the worker's wage, and show how it gives rise to patterns of wage rigidity and efficiency wages. We also show that the worker's rent (i.e. excess payoff relative to the outside option) is equal to the highest shock value. The modeling ideas in this brief paper may be applied to macro-labour models and illuminate wage-rigidity phenomena.