Discussion of Deb, Li, and Mukherjee (2012):

Relational Contracts with Subjective Peer Evaluations

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The paper

Objective
- Study optimal use of peer evaluations to provide incentives to team

Strategy
- Relational contracting model with two agents
  - Agents have private signals of others’ performance — how should use?

Conclusion
- Peer evaluations used if relational incentives weak and signals good
  - Evaluation affects only others’ pay, and only if worst report and output
Agent’s effort generates nonverifiable output for principal
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Principal can incentivize with informal bonus — self-enforcing if

\[ \text{Value of bonus today} \leq \text{Future discounted value of relationship (over outside option)} \]
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Principal can incentivize with informal bonus — self-enforcing if:

Value of bonus today ≤ Future discounted value of relationship
(over outside option)

Given other parameters, relational incentives if δ large enough.
Add Public Peer Evaluations

- Two agents, each receives private signal of other’s effort
- Suppose first agents report signals publicly → verifiable reports
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- Suppose first agents report signals publicly → verifiable reports
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- Two agents, each receives private signal of other’s effort
- Suppose first agents report signals publicly $\rightarrow$ verifiable reports
- Must incentive truthful reporting: report has no effect on my pay
- Signals allow incentive provision even if static setting
  $\Rightarrow$ Valuable relationship for all discount factors
  $\Rightarrow$ Also allows to enforce relational bonus

Discount factor

Relational incentives + peer evaluations
Add Private Peer Evaluations

- Suppose now agents report signals privately
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  ⇒ Wage compression (MacLeod 2003 but with multiple agents)
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- Solution: Surplus destruction to make principal indifferent (Levin 2003, MacLeod 2003)
- Signals improve information but at a cost
  \[ \Rightarrow \text{Wage compression} \] (MacLeod 2003 but with multiple agents)
  \[ \Rightarrow \text{Use signals only if good enough (i.e., would use in static setting) and relational incentives weak} \]

\[ \begin{align*}
\text{Discount factor} & \quad \text{Relational incentives + peer evaluations} & \quad \text{Relational incentives} \\
0 & \quad \text{OR} & \quad \text{No incentives} \\
\delta^* & & 1
\end{align*} \]
My comments: Nice insights, relevant implications

- Relevant setting with very nice insights and important implications
  - E.g., consistent with evidence cited in Harvard Business Review cases

- Interaction between peer evaluations and relational incentives

- Answer why, when, and how

- Realistic environment where peer evaluations private
  - Implies more constraints to keep track of!

- Nice comparative statics on when peer evaluations are used
  - Can test empirically
My comments: What are the essential components?

- Many ingredients — more benchmarks would be useful

- Many intuitions unchanged; interesting to compare

- What happens if, in large team, reports are anonymous but public?

- Present as team incentives, but is team needed?

- Have signals provided by peer; what if exogenous private signals?
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- Many ingredients — more benchmarks would be useful
- Present as team incentives, but is team needed?
- Have signals provided by peer; what if exogenous private signals?
  - Many intuitions unchanged; interesting to compare
- Private peer reports motivated by real-world practices
  - What happens if, in large team, reports are anonymous but public?
My comments: Peer evaluations in dynamic context

- Ability to commit to pool $\Rightarrow$ Peer evaluation problem becomes static
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- Ability to commit to pool $\Rightarrow$ Peer evaluation problem becomes static
- Can endogenize surplus destruction to make problem dynamic?
  $\rightarrow$ Surplus destruction as conflict in relationship
  - Higher relationship value $\Rightarrow$ can destroy more surplus
My comments: Correlated signals

- Pay independent of my report even if signals correlated
  - But not if correlation depends on effort → use to detect shirking
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- Pay independent of my report even if signals correlated
  - But not if correlation depends on effort → use to detect shirking
- Study perfect correlation with prob $\theta$, no correlation with prob $1 - \theta$
- Would be interesting to extend to more general information structures
Thank you!