

Complexity and the Ratchet Effect

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Abstract

The ratchet effect is a well-known, and theoretically well understood, side effect of time-varying incentive pay: if future piece rates are set as a function of current effort, then workers should hold back effort to protect future piece rates. We study the hypothesis that firms can strategically introduce complexity into their incentive systems to “shroud” the ratchet effect. We conduct two field experiments with 3000 warehouse workers who are confronted with a complex incentive system and find a strong effect of incentives on effort but only a very small ratchet effect. In lab experiments with the same workers, we find that a simplified version of the incentive system used in the warehouse produces a strong ratchet effect. Workers who exhibit a ratchet effect in the lab experiments also reduce effort on the shop floor, underscoring the importance of bounded rationality and complexity for the effectiveness of incentive pay.