REVIEW
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Commentary

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In preparing my comment on Truman Bewley's work, I had the privilege of reading a draft of Professor Bewley's forthcoming book, *Why Wages Don't Fall During a Recession*. This book describes an extensive field study, in which Professor Bewley interviewed hundreds of business managers and labor leaders, seeking to understand the puzzling phenomenon of wage rigidity. The paper presented here is an outgrowth of this project. Before turning to the paper itself, I would like to make a few comments about the research enterprise more generally.

I am quite enthusiastic about the manuscript I read. There are three reasons why you should read this book. First, you will learn a lot of economics. In the course of discussing ideas raised in his interviews, Professor Bewley cites and discusses a vast literature (his book cites more than 1,000 papers!). The book provides an engaging way of becoming acquainted with the issues currently under debate in the study of motivation, compensation, labor markets, and macroeconomics. Second, the research makes important headway in understanding the nature of rigidities in labor markets. Bewley makes a number of striking and controversial claims about labor markets, but always in a clear, well-reasoned, and convincing manner. Finally, the book will challenge you to think hard about how to "do economics." Economic theorists generally implicitly follow the path laid out by Milton Friedman (1953): We hope that even though our assumptions are often self-consciously unrealistic, useful predictions about behavior can nonetheless be derived. Bewley's book reminds us that when assumptions drift too far from reality, theory is a futile exercise with no hope of shedding light on behavior. Professor Bewley describes the central conclusion of his work as follows:

> From the interviews, I conclude that wage rigidity stems from a desire to encourage loyalty, a motive that superficially seems incompatible with layoffs. My findings support none of the existing economic theories of wage rigidity, except those emphasizing the impact of pay cuts on morale. Other theories fail in part because they are based on the unrealistic psychological assumptions that people's abilities do not depend on their state of mind and that they are rational in the simplistic sense that they maximize a utility that depends only on their own consumption and working conditions, not on the welfare of others.

The paper presented at this conference provides theoretical musings designed to encourage readers to think about a world in which morale and mood are part of human behavior.

The idea here is to lay out a formal representation in which workers' decisions depend not merely on balancing utility of earnings against disutility of effort, but depend as well on morale—an internalization of organizational objectives—and mood—the worker's psychological state of mind. I do not know if the formalizations provided here or in the books are the most fruitful ways of incorporating morale and mood into models of worker-firm interactions.[1] Nonetheless, the exercise is useful as a way of clarifying how explicit consideration of mood and morale can change the usual predictions of agency theory. Indeed, it is clear that people do pay attention to the well-being of others, and that the way in which they do this depends critically on their own "mood." Bewley's work persuades me that this general idea can be important in understanding many features of workplace behavior.

[1] The model and discussion presented here are somewhat different than those in the book (and those presented at the conference itself). Readers are again encouraged to look at the book as well.

A simple story of a "rude driver" might provide a useful way of thinking about these kinds of motivation. Suppose you are traveling by automobile to an important engagement for which you definitely do not want to be late. Construction has closed the left lane of the highway, and you are stuck waiting, not too patiently, in the right lane as traffic inches its way toward the construction site. You notice in your rearview mirror a lone car whizzing past the "merge right" signs, bypassing drivers—yourself included—who have dutifully pulled into the right lane. The driver proceeds to the very last spot at which the car can physically remain in the left lane and signals right, hoping to pull in front of you! What do you do? Do you let him in or not?

The self-interest model normally employed by economists provides an easy answer. Letting the driver pull into your lane imposes a cost—it increases the probability that you will be late for your engagement—and gives you no benefit, so you do not let him in. Economists understand, though, that this simple way of viewing the problem is not exactly right. People are routinely altruistic; they pay attention to others' well-being. There are many examples in which ideas are incorporated into formal economic models, including, for instance, Gary Becker's (1991) work on the family and Matthew Rabin's (1993) theory of fairness. In the current context, you would surely be willing to let the driver pull in front of you if you noticed a pregnant woman in the car who appeared to be in labor.

The idea here is simple: People care about others and are often willing to sacrifice their own material well-being to benefit others. Moreover, in models like Rabin's and in empirical work like Andreoni and Miller (1996), people incorporate others' welfare into their own decision-making in generally predictable ways. For example, Andreoni and Miller conduct experiments which demonstrate that individuals' willingness to sacrifice money varies with the extent to which other individuals benefit from the sacrifice.

Returning to the scenario of the rude driver, though, it is clear that something besides even the altruism of Rabin is at work in most people's decision-making. Your decision of whether to let the driver pull in front may well depend not only on your assessment of the potential benefits to the driver (e.g., does he have a pregnant passenger?), but also on your gut-level belief about the driver's motives. If you believe the driver is indeed being rude or obnoxious, you may be anxious *not* to let him; you might even be willing to suffer some cost to avoid letting him in. On the other hand, if there is some indication that the driver was merely confused (perhaps he has an out-of-state license plate and a befuddled, contrite look on his face), you will be more inclined to let him in. The point is that your utility function evidently depends, at a minimum, on three factors: first, your own narrow, self-interested goal—to move through traffic as quickly as possible; second, your internalization of the other driver's goals; and, third, *your own mental state*, which in this case follows from your assessment of the other driver's motives. This last part of the decision-making process may be transparent at the time or may work at a largely subconscious level. It is self-evidently important in the rude driver scenario, and it may be important in other contexts as well.

By section 4 of his paper, Bewley works up to a representation of worker preferences that perhaps parallels the observations we glean from the rude driver scenario. Bewley's characterization of utility, both "conscious" and "unconscious," depends, as usual, on compensation and effort. It incorporates also an internalization of the goal of the firm's owners. This altruistic component is not generally included in theorists' representations of preferences, but as just noted, it is sometimes incorporated; it appears, for instance, as a central component in George Akerlof's (1982) gift exchange model of worker-firm interaction. Bewley pushes further, though, by positing a model that includes "morale," which he suggests has two key aspects: an internalization of the firm's goal (firm profit) and *his mental state* *or mood*. As in the rude driver story, an individual's behavior is affected by his own personal objectives and by an inclination to at least consider the well-being of others (in this case the employer), but all of this is tempered by a more elusive construct—mood or mental state.

Building from this basic representation of worker preferences, Bewley derives a number of implications that seem in accord with the observations he gathered in his field research. In so doing, he clearly demonstrates the viability and value of constructing a model that pays serious attention to motivations that (realistically) move beyond the usual assumption in principal–agent models. Bewley's work covers lots of ground, making suggestions about how to incorporate mood and morale, and also exploring cooperation, information sharing, and the relative merits of managers' use of morale and coercion.

This is a valuable contribution to behavioral economics as applied to the workplace; it provides seed ideas that other economists will find useful in doing their own theoretical work. Economists may find alternative ways of constructing realistic models of work motivation, models that include a serious effort to incorporate features like morale and mood. In this enterprise, they will do well to follow Professor Bewley's exemplary effort to see that their formal representations are firmly rooted in careful systematic observation of the real world.

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