Intrinsic and Instrumental Reciprocity: An Experimental Study*

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Abstract

We experimentally test a repeated veto game: in each of an infinite number of periods, Nature generates a pair of payoffs, one for each player. Although the sum of the players' payoffs is positive, one of the players may receive a negative payoff. Players simultaneously decide whether to approve such a proposal. If either of the players vetoes the proposal, both players get zero; otherwise, they receive the value generated by Nature. In this context, we devise an experiment to distinguish between alternative explanations of generous behavior (accepting negative payoffs): altruism and other-regarding preferences, intrinsic backward-looking reciprocity (reciprocal kindness), and instrumental forward-looking (or equilibrium) reciprocity. Our results are broadly consistent with the hypothesis that observed sacrifices are motivated by equilibrium selfish, forward-looking reciprocal behavior. For example, of the 132 subjects, 74.2% can be categorized strictly selfish in their motivation, 19.2% as having some altruistic or other regarding concerns, and 3.7% as taking kindness considerations into account.

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1 Introduction

Reciprocity is a significant part of the behavioral repertoire of humans (and other animals). People seem willing to sacrifice their material well being to help others. As summarized by Sobel (2005) such behavior comes in two basic varieties which he labels "intrinsic" and "instrumental" reciprocity. In intrinsic reciprocity, a kind (unkind) act by one social agent changes the preferences of the people he interacts with in such a way as to elicit kindness (unkindness) in response. Intrinsic reciprocity is therefore preference based and likely to depend on the context of the game being played and the perceived intensions of the players.[1] In these theories, because reciprocity is motivated by a positive (negative) interpretation of the intensions of one's opponent, how one arrives at a final payoff vector is an important component in determining whether behavior should be rewarded or punished. Such theories are "backward looking" since they rely on history to define the kindness of one's opponent. Other preference based theories of reciprocity include altruism and the interdependent preference theories of Fehr and Schmidt (1999), Bolton and Ockenfels (2000). These theories, while preference based, differ from intrinsic models by ignoring the process through which final outcomes are determined and concentrating on the final distributions themselves in isolation of the context of the game determining them. In other words, in these theories the preferences of agents are fixed and do not change in response to the behavior of others.

In contrast to intrinsic reciprocity, Sobel classifies reciprocity as instrumental if it is part of a repeated game strategy where agents sacrifice their short term gains in an effort to increase their long run (discounted) payoff. In such models, agents are capable of being perfectly selfish yet reciprocal behavior is observed as part of the equilibrium of the game. If Folk Theorems apply, a wide variety of behavior can emerge along with a wide variety of equilibrium outcomes all determined by selfish agents who are "forward looking" in the sense that they care about the impact of their actions today on the perceptions and actions of their opponent in the future. The logic of the Folk Theorem is the logic of instrumental reciprocity (see Rubinstein (1979), Fudenberg and Maskin (1986) and Abreu (1988), and more directly

[1] See Rabin (1993) and Segal and Sobel (2007, 2008) and Blanco, Celen and Schotter (2010) for examples of such theories as well as Dufwenberg and Kirchsteiger (2004) and Charness and Dufwenberg (2006) for examples of reciprocity in the context of psychological games and Falk, Fehr, and Fischbacher (2003) and Blount (1995) for experimental evidence supporting intrinsic reciprocity models in the context of bargaining (ultimatum) games and Fehr and Gächter (1998) and Fehr, Gächter, and Kirchsteiger (1997) for examples of the impact of reciprocity on markets and contracts.

for this paper (Cabral (2005)).

Previous experimental literature has had a difficult time in distinguishing between these two types of reciprocity since virtually all of the experiments run have been conducted as either single-shot or finitely repeated games. [2] In one-shot or finitely-repeated-game experiments instrumental reciprocity is hard to identify since it requires that the game being played have an infinite horizon which, to our knowledge, none of the previous experiments have had. The most prominent exception is a recent paper by Dreber, Fudenberg and Rand (2010) which uses correlations between behavior in an infinitely repeated Prisoners' Dilemma game and a static Dictator game to demonstrate, as we do, that selfish motivations are mostly responsible for cooperation in the Prisoners' Dilemma game.

When reciprocal behavior is observed in finitely repeated games (where backward induction should eliminate it) some have argued that such behavior, while seemingly intrinsically motivated reciprocity, is actually the result of subjects inappropriately importing selfish infinitely repeated game logic and strategies from life into the lab. Evidence of this phenomenon is cleverly presented by Reubens and Suetens (2011). Alternatively, for evolutionary reasons, subjects may be conditioned to be reciprocal outside the lab where infinitely repeated situations are more abundant and mistake the lab as a place where such strategies apply. While it is certainly not our claim that intrinsic reciprocity does not exist or that it is not significant, we do think that one must be careful as to how we impute motives to observed reciprocal behavior.

In this paper we embed our experiment in an infinitely repeated veto game of the type studied theoretically by Cabral (2005). In such veto games, in each of an infinite number of periods, Nature generates a pair of payoffs, one for each player. Although the sum of the players' payoffs is positive, one of the players may receive a negative payoff. Efficient equilibria thus require that players inter-temporally exchange favors, i.e., accept negative payoffs in some period with the expectation that such a favor will be recip-

[2] This is true of ultimatum games (Guth, Schmittberger and Schuarze, 1982), dictatorship games (Hoffman and Spitzer, 1985), trust games (Berg, Dickhaut and McCabe, 1995), gift exchange games (Fehr, Gächter and Kirchsteiger, 1997), and promise games (Charness and Dufwenberg, 2006). Charness and Haruvy (2002) perform an experiment that tries to separate altruism, equity, and reciprocity-based motives but in a non-infinite setting. While in the static version of such experiments it is true that reciprocity behavior can not be exhibited by selfish agents, in an infinitely repeated game selfish people are perfectly capable of acting in what appears to be an altruistic or reciprocal manner.

Some of the few exceptions are Engle-Warnick and Ruffle (2006), Engle-Warnick and Slonim (2006), and Schotter and Sopher (2007). The latter use what they call "intergenerational" games.

rocated later in the interaction. An additional advantage of the repeated veto game is that, unlike most other repeated games, it admits a unique efficient equilibrium in the class of trigger strategy equilibria. We consider this equilibrium as the natural prediction of the selfish, rational behavior model and use its predictions as guide in our empirical section.

The repeated veto game is of significant theoretical and applied interest. Cabral (2005) applies it to the problem of international merger policy, that is, the situation when a merger must be approved by multiple national authorities. A related setting is that of interest rate setting by the European Central Bank, where individual member countries have veto power of changes on the interest rate level. An additional, closer to home, example is that of faculty recruitment, where different groups (e.g., micro and macro) have different preferences and hiring opportunities arise at an uneven rate.

All of these situations require that participants exchange favors over time. Hence, from the point of view of experimental economics, the infinitely repeated veto game provides an excellent testing ground for the relative importance of altruism, intrinsic and instrumental reciprocity and selfishness as determinants of behavior. This is what we attempt to do in this paper.

Methodologically, our paper makes several contributions since there are several features of our design that are new to the infinitely repeated game literature. In particular, as mentioned above, it is one of the first papers to examine reciprocal behavior in infinitely repeated games. Second, we present an innovation of some methodological use that ensures that no repeated interaction ends before at least some predetermined number of periods have transpired (in our experiment six) despite the fact that we use a probabilistic continuation rule to simulate discounting. [3]We do this by using a technique that makes the first six periods in any interaction deterministic with discounting yet allows these periods to blend into the stochastically ending portion of the experiment (periods 7 and above) in a behaviorally continuous manner. This allows us to make sure that we do not waste money on games that end "too soon." Third, two of our treatments have the added feature that when the last period is stochastically determined we inform the subjects that such period has arrived (see Reubens and Seutens (2010) for a similar treatment). In other words, while we use a stochastic stopping rule to end the infinitely repeated game, in two of our four treatments we inform our subjects when the last period has arrived. In the context of our experiments, this allows us to identify whether their behavior up until that point was motivated by reciprocal or selfish

[3]See Dal Bó and Fréchette (2011) for an excellent example of the approach where termination is stochastic.

motives.

Our results are broadly consistent with the hypothesis that observed sacrifices (accepting negative payoffs) are motivated by selfish, forward looking reciprocal behavior. In other words, subjects make favors in the expectation that their pair member will reciprocate such favors in future periods as opposed to rewarding previous kindness. Purely altruistic behavior is rejected as is intrinsic (kindness-based) models. More precisely, our logit regression results indicate that of the 132 subjects that were subjects in our experiments, 74.2% can be categorized strictly selfish in their motivation, 19.2% as having some altruistic or other regarding concerns, and 3.7% as taking kindness considerations into account. Our results therefore suggest that by ignoring instrumental reciprocity, previous experiments may have exaggerated the impact of altruism or backward-looking reciprocity.

In this paper we will proceed as follows. In Section 2 we will present the theory underlying infinitely repeated veto games in the context of the experiment we conduct. In Section 3 we present our hypothesis while in Section 4, we present our experimental design, In Section 5 we present our results. Finally in Section 6 we offer the conclusions.

2 Theories of agent behavior

Our theoretical analysis is based on the following *repeated veto game*.[4] Two players interact over an infinite series of periods. Both players discount future payoffs according to the discount factor δ. In each period t, Nature determines a *proposal*, a pair of payoff values $w_t = (w_{1t}, w_{2t})$ drawn from the set S according to the c.d.f. $F(w)$, which we assume is smooth. Both players observe both values in w_t. Both players then simultaneously decide whether or not to approve the proposal w_t. If both players accept, then player i receives payoff w_i. If at least one of the players rejects the proposal, then both players receive zero. Specifically, let x_{it} be player i's decision at time t, where $x_{it} = 1$ denotes approval and $x_{it} = 0$ denotes veto. Player i's payoff in period t is then given by

$$\pi_{it} = w_{it}\, x_{it}\, x_{jt}$$

Figure 1 illustrates a possible set S (where for simplicity we drop the time component of the subscript

[4] See Cabral (2005) for a more extensive discussion of the repeated veto game and an application to international merger policy.

of w). All points in S lead to a positive aggregate payoff.[5] We can consider three partitions of S. Points in region A yield a positive payoff to both players. Points in region D_i have the interesting property that (a) aggregate payoff is positive, (b) player j's payoff is negative.

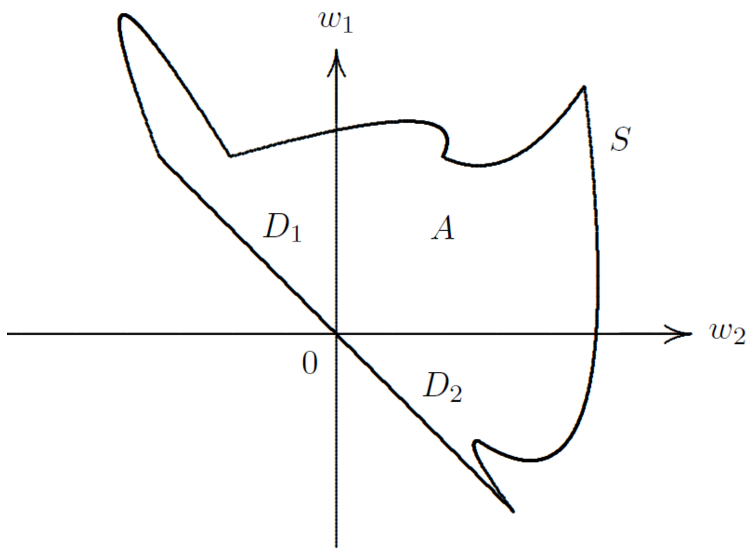

Figure 1: Payoff structure in a repeated veto game

It is straightforward to show that one equilibrium of this infinitely repeated game would be to play a static Nash equilibrium in every period where each player rejects all negative payoffs for himself and accepts only positive payoffs no matter what offer is made to his opponent, or alternatively rejects all offers no matter whether they are positive or negative.[6] Experimental and anecdotal evidence suggest, however, that subjects are frequently "nice" to other players, that is, approve proposals yielding negative payoff for them but a positive aggregate payoffs (that is, points in regions D_i). What theory can then explain the evidence? Our purpose in the present paper is to attempt to answer this question.

There are several reasons why outcomes do not correspond to the repeated play of static Nash equilibria. One first reason is that players care about other players' payoff: altruism or other regarding preferences. A second reason is that players follow some notion of reciprocity in their behavior: to the extent that

[5] Cabral (2005) considers the more general case when S includes points with negative aggregate payoff.

[6] As we will discuss later, this second equilibrium is unlikely to be played especially since it is weakly dominated by the first. Still, we list it because it is a logical possibility.

their partner has been kind in the past, reciprocating such kindness yields positive utility. Finally, a natural explanation based on economic theory is that the outcome of cooperation corresponds to a Nash equilibrium of the repeated game which is different from the static Nash equilibrium; that is, given repetition, players might achieve an equilibrium whereby some points in regions D_i get approved. We next develop each theoretical hypothesis in greater detail.

◊ Altruism and Other-Regarding Preferences. An explanation for "generous" behavior (proposals in region D_i that are approved) is altruism, the idea that a player's utility includes the amount earned by the other player. This is captured by $\Phi(w_{it}, w_{jt}) : S \to \mathbb{R}$.Specifically, suppose that, in each period, each player's utility is given by his payoff plus a positive coefficient α times the amount earned by the other player. Suppose moreover that players are myopic, that is, they do not consider the continuation of the game. Such altruistic preferences imply the following definition.

Definition 1 (altruism) *Under myopic, altruistic play,* $x_{it} = 1$ *if and only if* $\Phi(w_{it}, w_{jt}) > 0$*, where* $\frac{\partial \Phi}{\partial w_{it}} > 0$ *and* $\frac{\partial \Phi}{\partial w_{jt}} > 0$*.*

Figure 2 illustrates the linear case, when $\Phi(w_{it}, w_{jt}) = w_{it} + \alpha\ w_{jt}$ (where $\alpha > 0$ is the coefficient of altruism). In this case, we expect all proposals to the NE of the ℓ_1 and ℓ_2 lines to be approved.

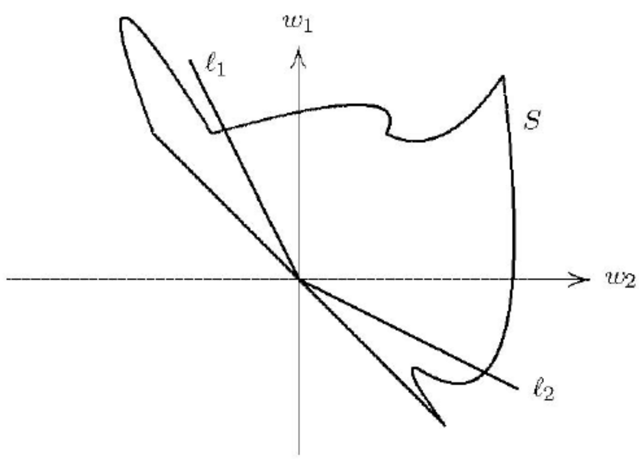

Figure 2: Altruistic, myopic equilibrium

Note that a similar result would hold if our subjects had various other types of other-regarding preferences such as those specified by Fehr and Schmidt (1999) and Bolton and Ockenfels (2000) since in both of these theories the decision to accept or reject an offer at any time t would depend both on one's own offer and that of one's opponent.

◊ Kindness (backward-looking) reciprocity. An alternative explanation for "generous" behavior (proposals in region D_i that are approved) is given by what we will call intrinsic or "kindness reciprocity." Such explanations are backward looking since a player looks back at the previous behavior of his opponent, makes a judgement about how kind she has been, and then decides whether to accept a negative payoff based on how negative the payoff is and how kind the opponent has been.

To formalize this we consider the following index of player i's kindness

$$k_{it} = \sum_{\tau=1}^{t-1}((x_{i\tau} - 1) - \frac{w_{i\tau}}{100})I(w_{i\tau} < 0),$$

where $I(\cdot)$ is the indicator variable. To understand the idea of k_{it}, consider a given period τ and suppose that $w_{i\tau} = -60$. If player i accepts this proposal (so that $x_{i\tau} = 1$), then we say he is being kind to his partner to the tune of $.60 = (x_{i\tau} - 1)$-$\frac{w_{i\tau}}{100}$ where $x_{i\tau} = 1$ and $w_{i\tau} = -60$. The maximum value of kindness in a given period is therefore 1; it corresponds to the case when player i accepts a sacrifice of -100. Suppose however that the player rejects the same proposal of -60 (so $x_{i\tau} = 0$). We then say he is being kind (or rather, unkind) to the tune of $-.40 = (x_{i\tau} - 1) - \frac{w_{i\tau}}{100}$, where $x_{i\tau} = 0$ and $x_{i\tau} = -60$. Intuitively, the idea is that kindness corresponds to accepting large negative offers. In the limit when $w_{i\tau_\tau} = -100$ is accepted, we get one unit of kindness. Conversely, unkindness corresponds to rejecting offers that would imply a small sacrifice to player i. In the limit when$x_{i\tau} = 0$ is rejected, we get one negative unit of kindness (or one unit of unkindness). Accepting an offer that implies a small loss is not considered to be either kind or unkind. In the limit when $x_{i\tau} = 0$ is accepted, we get $(x_{i\tau} - 1) - \frac{w_{i\tau}}{100} = 0$.Likewise,rejecting an offer that would imply a large loss is not considered to be either kind or unkind. In the limit when $w_{i\tau} = -100$ is rejected we again get $(x_{i\tau} - 1) - \frac{w_{i\tau}}{100} = 0$.

While one can think of many different types of kindness functions some of which weigh the past actions of opponents in a more complicated non-linear manner, given the constraints of our data in which average history lengths are approximately 10 periods, we suspect that none would be superior, many would be non-feasible and others basically equivalent.[7]

[7] For example, some might suggest just looking at last period's kindness to determine behavior today. While such a strategy is simple in that it is a strategy that requires only one period of memory, in our context it is not very useful since

If players are reciprocal we would expect a player's utility from approving a proposal is increasing in their partner's past kindness. A related notion, in the spirit of Rabin (1993), is that the weight of player j's payoff in player i's utility function is increasing in player j's past kindness towards player i.[8] However, it is important to note that Rabin's theory is only formulated for static, one-shot games played in normal form.[9] Such games are psychological games in the sense that each player's payoff depends on the first, second and perhaps higher-order beliefs about what he expects his opponent will do. Since our game is an infinitely repeated game for which there is a commonly observable behavior history, it is not unreasonable to assume that, in each period t, each player will use his opponent's history to formulate an assessment of her kindness. This leads to a different prediction regarding the outcome of the game:

Definition 2 (kindness (intrinsic) reciprocity) *In a kindness equilibrium,* $x_{it} = 1$ *if and only if* $\Phi(w_{it}, k_{jt}, w_{jt}) > 0$, *where* $\frac{\partial \Phi}{\partial w_{it}} > 0$, $\frac{\partial \Phi}{\partial k_{jt}} > 0$ *and* $\frac{\partial^2 \Phi}{\partial k_{jt} \partial w_{jt}} > 0$.

In the particular linear case, a proposal is approved if and only if $w_{it} + \alpha\, k_{jt} + \beta\, k_{jt}\, w_{jt} > 0$, where α and β are coefficients of kindness.[10]

◊ Equilibrium (forward-looking) reciprocity. Economists have understood for a long time that selfish, individual utility maximization is consistent with the observation of cooperative behavior when games are infinitely repeated. While it is possible to define an infinite set of possible strategies in the repeated veto game (as in any repeated game), we concentrate, as is often the case, on trigger strategy equilibria. The idea of a trigger strategy equilibrium is to consider a "cooperative phase," where each player chooses $x_i^C(w_i, w_j)$; and a "punishment phase," where each player plays the static Nash equilibrium strategy $x_i^N(w_i, w_j)$; and the rule that players choose $x^C(w_i, w_j)$ so long as all players have chosen $x^C(w_i, w_j)$ in previous periods.

in many periods one's opponent's behavior is not informative of their kindness. For example, when an opponent receives a very positive offer and accepts or a very negative offer and rejects then we get no insight into their ultimate kindness since they can be expected to accept very positive offers and reject very negative ones. So if we just used last period's kindness we would have many uninformative observations.

[8] Specifically, the idea is that player i's utility is a function of his "material" payoff, that is, w_{it}, as well as his belief regarding player j's intentions. The latter, in turn, are an increasing function of player j past kindness.

[9] See Dufwenberg and Kirchsteiger (2004) for an extension to extensive-form games.

[10] We could have, of course, used a more complicated (non-linear) kindness funtion but there is no loss in generality in the specifcation we use.

Specifically, let $x_i^k(w_i, w_j) : S \rightarrow \{0, 1\}$ be an action mapping from the set of possible proposals into the set of possible actions in each period, where 1 corresponds to approval, 0 to veto; and $k = C, N$. With some abuse of notation, let $x_{i\,t}$ be player i's actual choice at time t. Define the following cooperation indicator:

$$c_t \equiv \begin{cases} 1 & if \quad x_{i\tau} = x_i^C(w_{i\tau}, w_{j\tau}),\ \forall\, i, \tau < t \\ 0 & otherwise \end{cases}$$

Then a trigger-strategy equilibrium is defined as follows.

Definition 3 *A trigger-strategy equilibrium is characterized by strategies*

$$x_{it} = \begin{cases} x_i^C & if \quad c_t = 1 \\ x_i^N & if \quad c_t = 0 \end{cases}$$

Notice that there is a Nash equilibrium strategy which is simply to approve a proposal if payoff is positive: $x_i^N(w_i, w_j) = 1$ iff $w_i \geq 0$. As we will see below, this is not the only Nash equilibrium that can be used in the punishment phase. However, depending on what Nash equilibrium is assumed to occur, we can sustain different payoffs in equilibrium. We are interested in characterizing those equilibria that are optimal given an out-of-equilibrium threat.

Definition 4 *An optimal equilibrium is a trigger strategy equilibrium that maximizes the sum of the players' expected discounted payoff.*

Proposition 1 *(Equilibrium (Instrumental) Reciprocity) For a given threat to be used in the punishment phase, there exists a unique optimal equilibrium, and it is such that $x_i^C(w_i, w_j) = 1$ if and only if $w_i \geq -\ell_i$, where ℓ_i is increasing in δ and $\ell_i = 0$ if $\delta = 0$.*

A proof may be found in the appendix. Proposition 1 is illustrated by Figure 3.

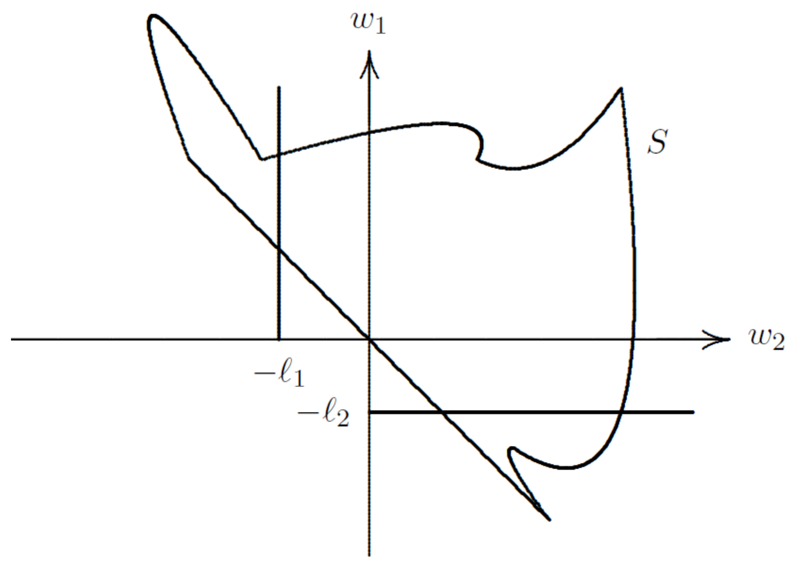

Figure 3: Optimal Threshold Equilibrium

Proposition 1 states that along the equilibrium path of the optimal equilibrium, all proposals in S such that $w_1 > -\ell_1$ and $w_2 > -\ell_2$ are approved, and all the other ones are vetoed. Furthermore, for a given static Nash equilibrium to be used as a threat strategy in the punishment phase, there is only one pair (ℓ_1, ℓ_2) that maximizes the sum of equilibrium payoffs. Although in any static Nash equilibrium, a player rejects any offer that gives negative payoffs to himself, there are two classes of static pure strategy Nash equilibria for this game each of which can be used as a threat in the punishment phase. In the first class a player accepts a proposal if and only if his payoff is positive. This is a static Nash equilibrium that has a positive expected payoff. In the second class, all proposals are rejected even if they offer a positive payoff for the player. When this strategy is used the player receives a zero payoff. During the punishment phase players may use the strategies from either class of Nash equilibria. In the proof of the Proposition 1, we establish that whichever Nash strategy is used as a threat, there exists a unique threshold strategy that maximizes the sum of the payoffs. Obviously the second class of Nash equilibria (rejecting all offers) is a more serious threat than the first type and hence can sustain higher payoffs in equilibrium. In fact, when the second class of Nash equilibria is used in the punishment phase, we achieve the optimal trigger strategy equilibrium. Despite this fact, we consider equilibria in which subjects accept all positive offers more natural for two reasons. First it is an equilibrium in weakly dominant strategies, i.e., the strategy of rejecting all offers is weakly denominated by one in which only negative offers are rejected. Second, with the parameters used in our experiment, the threshold consistent with the first class of equilibria is -27 while it is -88 for members of the second class.[11] As our data indicates, while we present strong evidence that subjects use threshold strategies, we can easily reject the idea that the threshold was -88 (and in several cases not reject -27). (In the appendix, we calculate the equilibrium thresholds for each class of threats.) Hence we will look to our data for evidence of trigger strategy equilibria with Nash reversion of the first type.

3 Hypotheses

The theory of instrumental reciprocity being tested here is characterized by two main features; thresholds and triggers. Thresholds characterize the cooperative phase while triggers characterize the punishment phase. If thresholds are employed by our subjects then we can rule out altruism or other-regarding preferences as a behavioral explanation since thresholds imply that the probability of accepting an offer in any round is independent of the offer made to one's opponent while altruism and other-regarding preferences suggest that the probability of accepting an offer depends on the offer of one's cohort. Hypotheses 1 and 2 concern these two features of our equilibrium.

Hypothesis 1 *Thresholds: Subjects base their rejections of offers on the basis of a threshold above which offers are accepted and below which they are rejected. The probability that player i accepts a proposal is increasing in player i's payoff and independent of j's payoff .*

The first part of this hypothesis obviously tests the threshold property of our model while the second part allows us to separate the impact of Instrumental Reciprocity from Altruism (or other-regarding preferences in general) since, as stated above, Instrumental Reciprocity with thresholds indicates that the rejection of an offer by subject i is independent of the offer made to subject j, while Altruism and other-regarding preference theories indicate that the probability of rejection depends on both offers. If we discover that including consideration of an opponent's offer adds nothing to our ability to predict the

[11] In the results section, we report thresholds as $-l$ rather than l to emphasize that the subjects accept negative payoffs for themselves.

probability that an offer is accepted, then we have provided evidence against altruistic and other-regarding preferences and in support of instrumental reciprocity.

Note that the fact that people use thresholds is only part of the demonstration that they were adhering to a forward looking reciprocal equilibrium since such an equilibrium also requires subjects to punish their opponent for the remainder of their interaction when they deviate. The punishment is to accept only non-negative offers. This yields the following hypothesis.

Hypothesis 2 *Trigger Strategies: Subjects employ trigger strategies when playing the repeated veto game.*

As Sobel (2005) has indicated, Intrinsic or preference-based reciprocity is a function of the previous behavior of one's opponent. If one's opponent has behaved in a kind manner, then such kindness changes the attitude of a decision maker towards his opponent by increasing the weight attached to his or her payoff in the decision maker's utility function. The opposite is true if the opponent behaves badly. Hypothesis 3 tests this Intrinsic Backward-Looking (or Reciprocal Kindness) hypothesis and distinguishes it from both Altruism and Instrumental Reciprocity since neither of those theories are influenced by the past behavior of one's opponent. Instrumental reciprocity simply compares the current offer to the subject's threshold while Altruism looks at the value of both current offers. Neither look at the previous behavior of one's opponent

Hypothesis 3 *Kindness and Backward-Looking Reciprocity:The probability that player i accepts a proposal is increasing in player j's kindness index.*

While both Instrumental and Intrinsic Reciprocity exhibit reciprocal behavior, they do so for different reasons. With Intrinsic Reciprocity, a subject is rewarded for previous kindness while with Instrumental reciprocity one cooperates (accepts a negative offer) in period t in the hope that such cooperation will be reciprocated in the future. This would imply that if it were announced to both players that their relationship would end in the current period, then we should not observe any subject accepting a negative offer in that period if he or she subscribed to the Instrumental or Forward Looking -Kindness theory (since there is no future left), while a subscriber of the Intrinsic or Backward-Looking kindness theory would reciprocate if the previous kindness level of his or her opponent were high enough. In other words, when there is no tomorrow there is no role for Forward-Looking reciprocity yet Backward-looking reciprocity may still operate.

Hypothesis 4 *The probability that player i accepts a negative proposal in any period t_i depends on whether the subject is informed that that period is the last period in the relationship he is in.*

Of these four hypotheses, Hypotheses 1-2 investigate Instrumental (Forward-Looking) Reciprocity. While Hypothesis 1 attempts to separate it from Myopic Altruism Hypothesis 2 investigates whether trigger strategies were used. Hypotheses 3 and 4 try to identify whether Intrinsic (Backward Looking) or Instrumental (Forward Looking) behavior is what is observed in the data.

In the next two sections we describe the experiment we designed to test these various hypotheses (Section 4) and analyze statistically the data produced by the experiment (Section 5).

4 Experiment procedures and design

Our experimental design was created in an effort to test the theories described above. While we ran four treatments (to be described below) the experimental task engaged in by our subjects in each treatment was identical and can be described as follows. In each period, a pair of potential payoffs or offers (w_1, w_2) is randomly determined. These values are uniformly drawn from the set determined by the following conditions:

$$-100 \leq w_i \leq 100, \ 0 \leq w_1 + w_2 \leq 100$$

This set is illustrated by the shaded area in Figure 4.

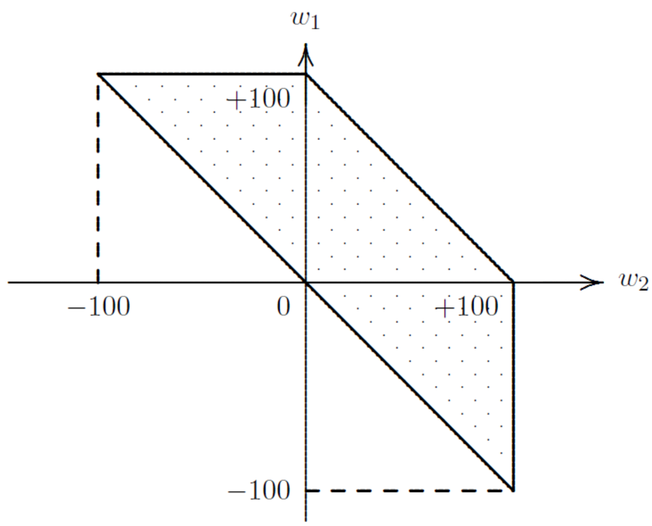

Figure 4: Experimental proposals generated.

Both players observe both values (w_1, w_2). Players then simultaneously decide whether or not to approve the proposal. If both players approve the proposal, then each gets a payoff w_i. If at least one player vetoes the proposal, then both players receive 0.

The underlying model we test is one involving an infinitely repeated game. Following the common practice, we implement the infinitely repeated game as a repeated game that ends after each period with a continuation probability δ (hazard rate$(1-\delta)$). In fact, for a risk-neutral player time discount and the probability a game will end are substitute elements in the discount factor.

This procedure creates an obvious practical problem, namely the possibility that the actual experiment lasts for a very short (maybe just one) period. In order to obviate this problem, we created a minimum time horizon, $T_{\min}$. Play of the game lasts at least $T_{\min}$ periods for sure; and for $t > T_{\min}$, we apply the hazard rate $1-\delta$. Moreover, for $t < T_{\min}$ we introduce a payoff multiplier which decreases at rate δ. This implies that, for a risk-neutral player, the future looks the same at every period of the game.

More generally, the formula for the multiplier x_t is

$$x_t = \begin{cases} \delta^{(t-T_{\min})} & if \quad t \leq T_{\min} \\ 1 & if \quad t > T_{\min}, \end{cases}$$

and the values used in the experiment are given in Table 1.

Table 1:

Period Payoff Multipliers

Period	Multiplier
1	3.05
2	2.44
3	1.95
4	1.56
5	1.25
6	1.00
7+	1.00

Note that in all periods before period 7, where stochastic discounting starts, the payoffs are multiplied by a constant greater than 1. For example, all payoffs earned in period 1 are multiplied by 3.05 making them more valuable than those earned in period 4, where the multiplier is only 1.56. The multiplier decreases until period 6 where it is equal to 1 and remains at that level from that point on. Note, however, that in period 7 the hazard rate δ takes over and it is in place from period 7 onward.

Table 2 presents the parameter values we used in our experiment. The minimum number of periods was set at $T_{min} = 6$ and the discount rate set at $\delta = .8$ (that is, after the sixth period the particular game ended with probability 20%). Each subject played this "infinitely" repeated game ten times (that is, there were 10 rounds). Finally, the resulting equilibrium thresholds under the efficient equilibrium hypothesis is given by -27 (see the Appendix for the calculations).

In the experiment, 132 subjects were recruited from the undergraduate population at New York University via an electronic recruitment system that sends all subjects in the subject pool an e-mail offering them an opportunity to participate. Subjects played for francs which were converted into dollars at the rate of .6c per Franc.

Table 2: Experimental Parameters and Equilibrium Values

Parameter	Value
Discount rate	0.8
Number of Rounds	10
Min number of periods ($\mathbf{T}_{\min}$)	6
Equilibrium threshold	-27

4.1 Experimental Design

The experiment consisted of four treatments which differed by the matching protocol used and the level of information offered subjects in the last period of each round. In all treatments, subjects played ten rounds of an "infinitely" repeated game. Subjects did not know ex-ante how many periods each round would last for, though they knew that there was a random continuation probability of $\delta = 0.8$. In two treatments (Treatments 2 and 4), subjects were randomly rematched with a new partner in each round, that is, after each "infinitely" repeated game (randomly) ended, while in the other two treatments (Treatments 1 and 3) subjects stayed with their first round match for the entire 10 rounds of the experiment. Furthermore, in Treatments 2 and 3, before playing the last period of each round, subjects were told that the end-period had arrived, that is, that the period they were about to begin would be the last period of the current "infinitely" repeated game. In the remaining two treatments, (Treatment 1 and 4, no such information was offered. In short, we conducted a 2 x 2 design with the treatments designated as Fixed Matching Low information (Treatment 1), Random Matching High Information (Treatment 2), Fixed Matching High Information (Treatment 3) and Random Matching Low Information (Treatment 4).

We ran these treatments for two reasons. First, we used random matching because we feared that, with fixed matching, the ten rounds of the "infinitely" repeated game might lose their independence. For example, subjects may build up a kindness reputation that spans across rounds. For other purposes, fixed matching is desirable. Second, we varied the last period information in order to compare the relative merits of the forward and backward reciprocity hypotheses. Table 3 presents our experiment's design.

Table 3: Experimental Design

Treatment	Matching	Information: Last Period Known	# of Subjects
1	Fixed	No	30
2	Random	Yes	28
3	Fixed	Yes	32
4	Random	No	42
Total			132

5 Results

In this section we will present the results of our experiment. We will do this by testing each of the hypotheses stated above on the individual level using the data generated by our experiment.

5.1 Hypothesis 1

To discuss Hypothesis 1 we will start with a descriptive analysis.

Figures 5a and 5b display the set of offers presented to two subjects in our Treatment 1, along with an indication of which offers were rejected dark (blue) diamonds) and which were accepted light (purple) squares.

Figures 5a and 5b: Individual Acceptance Behavior

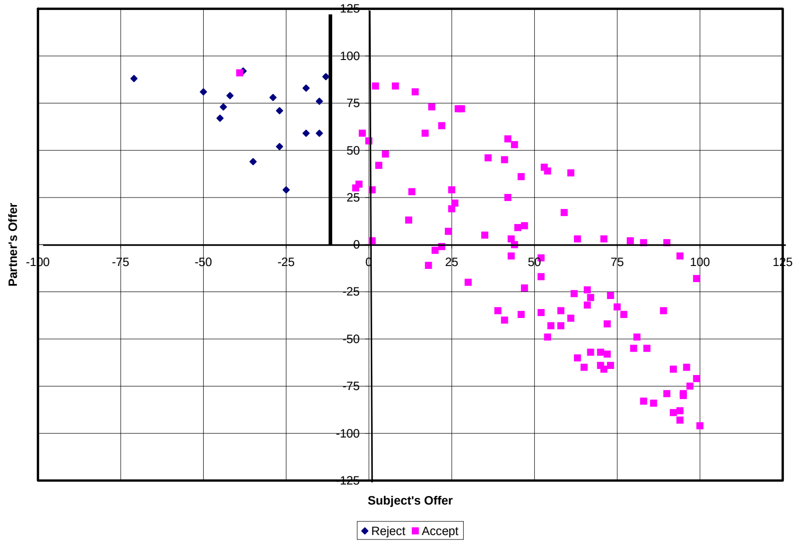

Figure 5a

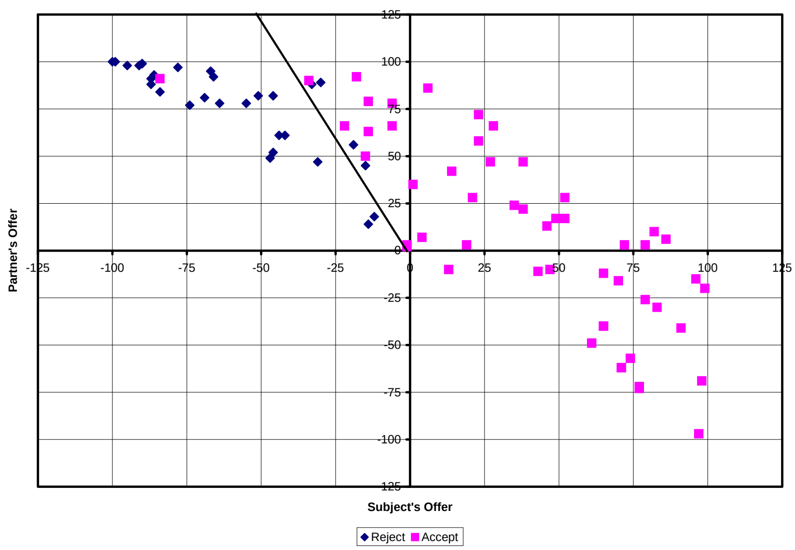

Figure 5b

If Proposition 1 (and Hypothesis 1) is predictive of behavior, then in these graphs we should see a sharp division between offers that were accepted and those that were rejected with a rejection boundary separating the two that has an infinite slope. In other words, if we look at the boundary between the accepted and rejected offers it should not be the case that the boundary between accepted and rejected offers has a positive finite slope.

As we can see, in Figure 5a this is certainly the case. For this subject (except for one observation) rejection behavior has the threshold property; offers above the threshold are accepted and those below are rejected regardless of the offer they imply for their opponent. Obviously, this was not the case for all subjects, which is why we also present Figure 5b that shows the behavior of a subject whose attitudes appear to be more consistent with altruism since he seems willing to accept somewhat disadvantages offers as long as they offer a large gain for his opponent. As our more formal regression analysis will indicate, these types of subjects are more the overwhelming exception than the rule.

Figures 6a and 6b (again from the Treatment 1) look at the data in another way. On the horizontal axis we have the offer made to a given subject while on the vertical axis we measure two things. The first is a binary $\{0,1\}$ variable that takes a value of zero if an offer was rejected and a value of 1 if it was accepted. Second we measure the probability that a given offer is accepted using a logit regression where the binary accept/reject variable is regressed on a subject's own offer. If threshold behavior characterized a subject's behavior, then, when a simple logit function is fit to this data to explain acceptance behavior, our estimated logit regression should be a step function indicating that the probability of acceptance for offers below the step (threshold) is zero while it is one for offers above the threshold.

To start consider Figures 6a and 6b which presents the acceptance behavior of subjects 19 and 13 in Treatment 1 over the 10 rounds of his participation in the game.

Figures 6a and 6b: Acceptance Functions

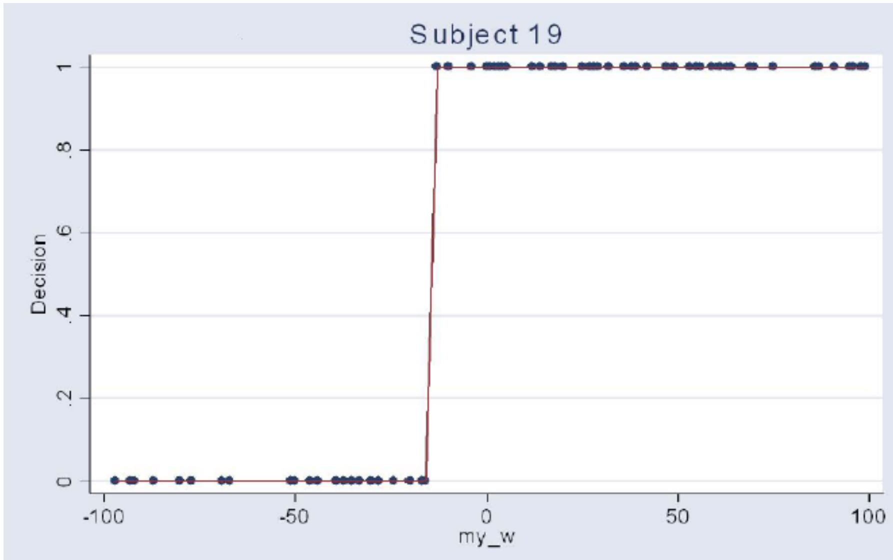

Figure 6a

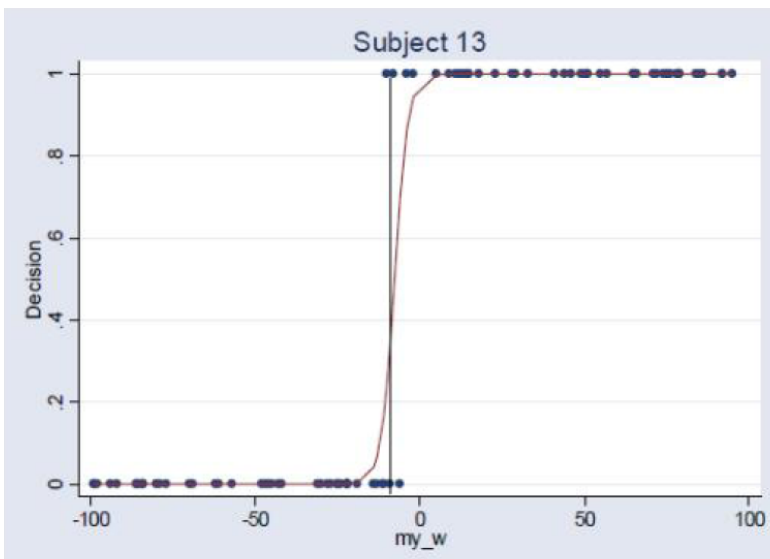

Figure 6b

In Figure 6a we present our acceptance/rejection logit function for Subject 19 estimated by regressing his binary {0,1} response to his payoff offer. Note that Subject 19 behaves exactly as a subject should if he or she was adhering to a strict threshold acceptance function. All offers below his threshold of -15 are accepted with probability 0 (rejected with probability 1) while those above the threshold are accepted with probability 1.

Subject 13 depicted in Figure 6b is a little different since his reject and accept regions for offers overlap. This means that this subject does not have a clear acceptance threshold. However, note that he is not far from perfect threshold behavior.

This discussion naturally leads us to look for a metric to use in assessing how far away a subject is from step function behavior and the pseudo threshold he is using. To do this we employ a very simple one which is to find the threshold which is such that we can fit a step-function to the data exactly by eliminating the minimal number of observations. To illustrate, consider Figure 6b and Subject 13. From the logit acceptance function depicted there we see that, as opposed to Subject 19, this subject is not using a strict threshold acceptance function. This is true because the set of rejected and accepted offers overlap so there is not a clear separation between the sets of rejected and accepted offers. However, note that if we simply remove 2 observations from his data set (those to the right of the straight line on the bottom) we can establish a strict step function so this subject is 2 observations away from behaving as if he or she had a threshold strategy with a step at -10. Our metric then would award him a score of 2 and define his pseudo threshold as -10.

Tables 4a-4d presents, for each treatment, the estimated thresholds for each subject along with the number of observations that need to be eliminated to create perfect threshold behavior. This is followed by the percentage of the data not explained by these thresholds. Note that the exact threshold can not be uniquely defined by our procedure since there may be regions where no observations occur which straddle the actual threshold used. For that reason we provide two thresholds per subject (min and max) each of which can be used to estimate our threshold along with the mean threshold. In the remainder of the paper when we refer to a subject's threshold we will be referring to the mean stated in this table.

Tables 4a-d here

As we can see from Tables 4a-4d, while not all subjects employed a perfect threshold strategy, many of them were in fact close to doing so in the sense that, on average, we only need to remove a few observations from each one in order to establish perfect threshold behavior. More precisely, note that over all rounds we only need to eliminate on average 5.43, 5.96, 5.46, and 5.5 observations from any subject in our four treatments respectively in order to establish perfect step-function behavior for him or her.[12] In addition, the maintained hypothesis that subjects used a threshold strategy is successful in explaining a large percentage of the data. For example, over all rounds the mean percentage of the data explained by our estimated thresholds are 94.38%, 94.05%, 94.32%, and 94.13% for treatments 1, 2, 3, and 4 respectively. This is strong support for the as if assumption that threshold behavior was operative.

These statistics actually under estimate how well threshold behavior fits our data. For example, from the logit regressions we will report on later in this section, our subjects naturally fall into two categories; those whose behavior can be explained exclusively with reference to one's own offer and those who take the offers of one's opponent into account as well. Among the former group (constituting 98 of our 132 subjects) the mean number of observations that need to be eliminated in order to perfectly fit our rejection data with a step function is 3.48 while among those (26 subjects) who also care about one's opponent's offer (potential altruistic or other-regarding preference types), the same number is 12.5. In other words, if we look only at the 74.2% of our subjects who exhibit strictly selfish behavior, our closeness index implies a closer fit.[13]

To test the second part of Hypothesis 1, we estimate a logit acceptance/rejection function for each subject i by estimating the probability that i accepts a offer w_{it} given that w_{jt} was offered to his pair member. We also include our previously defined opponent's kindness" variable, k_{jt}, in this regression, indicating the kindness of a subject's opponent up until the current period. In other words, we code the variable a_{it} as a zero if the offer in period t was rejected and 1 if it was accepted and we regress a_{it} on w_{it}, w_{jt}, k_{jt} and a constant. If Hypothesis 1 is accepted, then the coefficient on the w_{jt} variable should be insignificantly different from zero while that of the w_{it} should be positive and significantly so. Note that accepting Hypothesis 1 is equivalent to rejecting the Myopic Altruistic or other-regarding preferences since those theories require a significantly positive coefficient on the w_{jt} variable. Tables 5a -5d present the results of our logit regressions run at the individual level for our three treatments.

Tables 5a-5d here

As Tables 5a-5d clearly indicates, it appears that the probability of rejecting an offer for subjects is primarily a function of the offer they receive and not that received by their opponent. For example, over

[12] The median of number of unexplained points are 3, 4, 3.5, and 2.5 in our four treatments respectively.

[13] Only 8 subjects can not be classifed at all.

all subjects and all treatments of the 132 subjects who participated in our experiment,[14] 12 had behavior that was perfectly described by thresholds in the sense that a step function (explaining rejections as a function of a subject's own offer) perfectly fit their data. For these subjects the estimated logit regression did not converge yet it is obvious that they only considered their own offer when contemplating rejections. Including these subjects, 98 subjects (86 plus the 12 with a perfect fit) had significant coefficients (at the 5% level) only on their own offer variable, w_{it}, and no significant coefficient on their opponent's offer. Of these subjects 26 also had significant coefficients on the w_{jt} variable. In other words, while 86 subjects had significant coefficients on w_{it} only, none had significant coefficients only on w_{jt}. (The coefficients for w_{it} and w_{jt} that were significant were all of the correct (positive) sign.) In short, the primary determinant of rejection behavior seems to be one's own offer and not that of one's opponent. (We will discuss the coefficients on the kindness variable, k_{jt}, in a later section.)

These results present support for the threshold property of the Instrumental Reciprocity Hypothesis and for rejection of Myopic Altruism and other-regarding preferences since, under those hypothesis, a subject would have to take into effect one's opponent's offer in determining the rejection and acceptance of an offer pair.

It is one thing to suggest that subjects behaved in a manner consistent with threshold strategies and yet another to suggest that they employed the theoretically optimal threshold of -27 in that strategy. Here our results suggest that while subjects did not use the theoretically optimal threshold in Random Matching treatments they did in the fixed matching treatments. More precisely, mean thresholds used by our subjects over all rounds in Random Matching treatments (Treatments 2, and 4) were -12.52 and -9.75 respectively which were significantly less than -27 using a t-test (t=4.5457, p = 0.0001; t=5.5065, p=0.0000). On the other hand, in the Fixed Matching treatments (Treatments 1 and 3), mean thresholds (-18.85 and -18.89, respectively) and for these thresholds we can not reject the hypothesis that they employed a threshold of -27 at 5% level (t=1.8080, p=0.0810; t=1.6119, p=0.1171).

In conclusion, we have presented strong support for the idea that subjects employ threshold strategies. This result leads to rejection of the hypothesis that subjects were myopically altruistic or other regarding. We could not support the hypothesis that subjects employed the optimal thresholds, however.

[14] If we restricts this Logit regression to only consider negative values for a subject's own offer, we get ery vsimilar results.

5.2 Hypothesis 2

The theory underlying these experiments relies on the use of trigger strategies with optimal thresholds. While we have offered support for the existence of threshold behavior, it is harder to detect whether our subjects used trigger strategies since punishments are only employed out of equilibrium. Given our data, however, it is hard to observe such out-of-equilibrium behavior. For example, one test as to whether triggers were employed would be to find a subject rejecting an offer that is better than what he/she had already accepted in an earlier period. This is true because if a threshold/trigger strategy is being employed, in the cooperative phase once an offer is accepted, all offers better than that one should be accepted as well. This would signal that the punishment phase had started. In our data, however, such occurrences are very rare (less than 1%) and, as a result, this test can not be used as evidence that triggers were employed.

Another feature of trigger strategies that should be observable in our data is the use of a common threshold for subjects who are paired together in the Fixed Matching Treatment. This is necessary since it must be commonly agreed upon as to when the punishment phase should be triggered. Hence, if optimal trigger strategies with the threshold property were used it would have to be the case that our paired subjects used the same threshold during the experiment or at least converged to the same common threshold as time progressed. (Remember, for our experiment the optimal trigger is unique).[15] The establishment of a common threshold takes time, however, at least for those subjects who do not have the ability to solve for the optimal equilibrium strategy. Hence, one explanation for the behavior of our subjects is that while they quickly learned to use a threshold strategy they had to interact over time to establish a common threshold upon which to base their trigger. If this is in fact the case, we should see the difference between the thresholds used by paired subjects in the Fixed matching treatments converge over rounds. This is in fact what we see in Tables 6a and 6b.

[15] In fact, if behavior was optimal this common threshold would need to be -27.

Table 6a: Difference in Pair Thresholds:

Fixed-Matching Low-Information Treatment

Format: Difference (Threshold1, Threshold 2)

Pair	**All rounds**	**Rounds 1-5**	**Rounds 6-10**
1-4	5 (-10,-5)	3 (-8,-5)	1 (-10,-9)
2-18	13 (-9, -22)	15 (-10, -25)	3 (-7, -10)
5-13	1 (-6,-7)	10 (-15,-5)	3 (-6,-9)
8-19	6 (-8, -14)	9 (-5,-14)	3 (-10,-13)
11-16	1 (0,-1)	11 (-12, -1)	0 (+2,+2)
21-27	1 (-1, 0)	9 (-1, +8)	0 (-1, -1)
23-26	4 (-4, 0)	13 (+9, -4)	2 (+2, +4)
24-28	4 (-8, -12)	10 (-7, -17)	2 (-11, -9)
25-29	22 (-19, +3)	23 (-19, +4)	1 (-2, -3)
Mean	6.3	11.4	1.7

Table 6b: Difference in Pair Thresholds Fixed

Matching High Information Treatment

Pair	**All rounds**	**Rounds 1-5**	**Rounds 6-10**
59-80	1 (-1 0)	9 (+8, -1)	4 (-4, 0)
65-71	22 (-23, -1)	23 (-24, -1)	12 (-14, -2)
67-73	4 (-3,+1)	6 (-3, +3)	1 (-3, -2)
72-79	7 (0, -7)	1 (0, -1)	9 (+2, -7)
83-88	5 (1, -4)	10 (-1, -11)	2 (+1, +3)
85-87	1 (-4,-3)	8 (-4, -12)	3 (+7, +4)
86-89	1 (+5, +4)	1 (+4, +3)	5 (-8, -2)
Mean	5.9	8.6	5.1

Tables 6a and 6b present the differences between the thresholds of paired subjects in our Fixed Matching Low and High Information Treatments and calculates this difference for the first and last five rounds of the experiment. As we can see, there is a general movement toward convergence in the thresholds used which is most pronounced in the Fixed Matching Low Information treatment where, in rounds 6-10 the mean difference in the thresholds used was 1.7. This convergence lends support to the ideas that our subjects were using trigger strategies but that it took time for our subjects to agree on a common threshold to serve as a trigger.

5.3 Hypothesis 3

If subjects subscribe to Kindness or Backward-looking reciprocity then the probability of accepting a negative offer in any period, t, should be positively related to the previous kindness of one's opponent up until period t-1. To test this hypothesis refer back to the regression reported in Tables 5a-5c where we regressed our binary acceptance decision a_{it} on a subject's offer in period t, w_{it}, his opponent's offer w_{jt}, and his opponent's kindness, k_{jt} up to and including period t-1.

As is obvious from this table, we can strongly reject the hypothesis that subjects consider the previous kindness of their opponents when deciding whether or not to reject an offer. Of the 121 relevant regressions there was only five in which the kindness variable was significant at the 5% level. In other words, it appears as if subjects overwhelmingly ignore the previous kindness of their opponent when deciding on whether to accept or reject an offer.

The above results should not suggest that kindness reciprocity has no impact at all on behavior. We suspect that over time our subjects do respond indirectly to the kindness of their opponent by altering the threshold they use to accept and reject offers. To test this hypothesis we perform the following simple exercise. Using the data from our Fixed Matching No Information treatment, Treatment 1, we first divide the data into early (rounds 1-5) and late (rounds 6-10) rounds. We then correlate the change in thresholds used by our subjects from the first five to the last five rounds with the kindness of their opponents over the first five rounds. If our hypothesis is correct then we would expect a negative correlation between first-five-round kindness and the change in the thresholds used with more kindness observed in the first five rounds leading to lower (more negative) thresholds in the last five rounds. The correlation performed indicates that the relationship is negative as it should be with a correlation coefficient of -0.292 which is significant at the 5 % level. Hence, it would appear that kindness has an indirect impact of reciprocity - the kinder one's opponent in the first five rounds the lower one's threshold is likely to be in the last five rounds. Such behavior may help to explain the convergence of thresholds noted on when discussing trigger strategies in Hypothesis 2.

5.4 Hypothesis 4

In our experimental design we run both fixed and random matching treatments with and without high information. In the High Information treatments we inform our subjects about the occurrence of the last round just before it is played. This allows a very natural test of whether subjects engage in backward (intrinsic) or forward looking (instrumental) reciprocity since, if subjects are backward looking, in the last round they should still be willing to reciprocate previous kindness with kind behavior by accepting a negative offer while, forward looking behavior would rule out such a kind act since in the last period of a rounds subjects know they have no future together and hence the motivation to reciprocate is gone. Hence if Instrumental reciprocity were the guide to behavior we should see less negative offers being accepted in the last period of those treatments where information was full than in either than the period just before the last or over all periods before the last. We expect to observe this behavior in the Random Matching treatments but not necessarily the Fixed Matching treatments since, in the Fixed Matching treatments, where people are rematched round after round, "last periods" lose their importance because subjects may still be willing to accept a low negative offer in a last period of round t in order to build a reputation that will be "reborn" in the round t+1 when they are rematched together. It is for this reason that we did the Random-Matching treatment in the first place.

As we see in Table 7a, our expectations were supported. Looking down column 1, we see that the fraction of negative offers accepted in the last period of the Random Matching Treatment was 0.112 while it was 0.191 for the period just before the last and 0.194 for all periods before the last. Note that, as expected, the same is not true for the Fixed Matching Treatment where the last period acceptance rates were 0.248 in the high-information treatment and 0.218 in the low information treatment. There are other comparisons which may be telling here as well. For example, we may want to compare the acceptance rates for subjects in the last periods of our two Random Matching treatments (Treatments 2 and 4) since both periods are last periods but in one that fact is known while in the other it is not. As we see, the acceptance rates are in fact lower with 0.112 of the offers being accepted when subjects know the offer made was a last period offer while 0.159 were accepted when they did not know.

Table 7a: Negative Offer Acceptance,

Last and Not Last Rounds: All Treatments

		Random High info	Fixed High info	Random Low info	Fixed Low info
	Mean	0.112	0.241	0.159	0.239
Last Period	SD	0.317	0.430	0.367	0.428
	N	98	116	157	113
	Mean	0.194	0.225	0.154	0.197
All Periods but	SD	0.396	0.418	0.361	0.398
Last	N	949	1033	1319	1026
	Mean	0.191	0.248	0.141	0.218
Next to	SD	0.395	0.434	0.349	0.415
Last Period	N	110	121	156	110

In order to control dependency of the aggregate data due to observations from same subjects, we ran fixed effect logit regressions on the panel data where the left hand variable, "decision" was coded as a binary {0,1} variable where 1 denoted acceptance and 0 rejection. This variable was regressed on one of a set of dummy variables to be described below. We generated two dummy variables: *information which* assigns 1 if an observation comes from a treatment with High Information (i.e. get information whether the current period is the last period) and *lastperiod* which assigns 1 if an observation comes from the last period. By looking at the last period data only, in the Random Matching treatments (Treatments 2 and 4) we find that *information* has a significant effect on rejecting negative offers. This is not the case, however, if we look at the next to last period or all periods but the last one (see Table 7b). Additionally, in the random matching with high information treatment, *lastperiod* has a significant effect on rejecting negative offers($coef. = -.078$, $SE = .038$, $N = 1047$, $p < .05$).

Table 7b: Testing Negative Offer Acceptance,

Last and Not Last Rounds: Random Matching Treatments

	Random Matching All but Last	Random Matching Last Period	Random Matching Next to Last Period
Information	-0.05	-1.00^{*}	0
(SE)	(0.137)	(0.455)	(0.506)
Subject Fixed Effects	YES	YES	YES
N	2268	255	266
R^2	0.17	.37	.30

$^{*}: p < .05$

One last comparison is interesting, and that is to compare the acceptance rates in the Random Matching High and Low information treatments for all periods before the last. In other words, in these periods while the subjects in the High Information treatment knew that that period's offer was not the last, subjects in the Low Information treatment had to form a subjective estimate of the probability that that offer would be the last, an estimate that presumably increased as time went on and was positive in each period past the sixth. Under these circumstances we would expect that the acceptance rate in the High Information treatment would be higher than in the Low Information treatment since presumably subjects knew that these were still reputation building periods while subjects in the Low Information treatment had a positive probability that this was the last period. Using data in the combined Low and High Random-Matching treatments for all periods but the last and regressing decision on *information (again* controlling subject fixed effects), supports the idea that acceptance rates are higher in the periods before the last when in the High-Information Treatment ($coef. = .25$, $SE = .087$, $N = 2268$, $p < .05$).

Our comments above lend support to the idea that most of the behavior we observed in this experiment, if it was reciprocal at all, was primary of the instrumental type. This is supported here by the fact that when subjects know they are in the last period of their interaction they tend to accept fewer negative offers while when they are not in the last period, but know that they will be informed when the last period comes, they accept more, presumably in an effort to keep their reputation alive. This last fact also indicates that a true test of whether subjects are reciprocal for instrumental or intrinsic reasons would be embedded in an infinitely repeated game experiment since behavior in periods that are known no to be the last may look reciprocal whereas they are actually part of a more cynical strategy.

5.5 Methodological contribution to infinitely repeated games experiments

In laboratory experiments, infinitely repeated games are induced by random termination. Using random termination may be costly, however, since some games may end quickly (even after only one period) and if they do they furnish little data for analysis. Because of this we introduce a novel method for our infinitely repeated game experiments that allows collecting more data from each subject. To do this subjects first play the repeated game for fixed number, k, of periods (six in our experiment) with a discount factor and then play with random termination from period k+1 onward. The probability of termination is derived from the discount factor so that theoretically the two parts of the game "blend" into each other seamlessly. If this blending was, in fact, seamless, we should not observe any discrete change in the rejection probabilities of negative offers in the last (sixth) period of the deterministic phase and the first (seventh) period of the stochastic termination period. If we did, that would be evidence of a behavioral shift as we entered the stochastic phase of the round. To test this we pooled all of our data and compared the proportion of subjects accepting negative offers over two adjacent periods: the last period played with a deterministic discount factor (period 6) and the first period with a random termination (period 7) (conditional on that period not being the last in any treatment with high information). What we find is that the fraction of negative offers rejected is practically identical across these two periods, 20% and 19.16% in the 6th and 7th periods, respectively, and these proportions are not significantly different (z=0.2706, p=0.7867). This result is what we hoped for since we wanted to smoothly bridge the transition between that portion of the game that was deterministic and that which was stochastic.

As a more formal approach to investigating whether acceptance behavior changes when we move across the boundary from periods 1-6 to periods 7 and beyond, we tested whether a structural break occurred in the estimated logit acceptance function between periods 1-6 and 7 and above, where the logit we were interested in had the {0,1} binary acceptance variable as a dependent variable and a subjects own offer (my_w) as the dependent variable using only those offers that were negative. To do this we first pooled all of our observations from all treatments. We then defined a dummy variable that takes a value of 0 if the observation came from period 1-6 and a value of 1 if it came from periods greater than 6. This dummy variable is the entered as an independent variable and interacted with the intercept and slope coefficient in our logit estimation using a random effects specification for the error terms. This yields the following model (Model 1): $acceptance = \alpha + \beta_1(my\_w) + \beta_2 D + \beta_3 D(my\_w) + v_i + \epsilon_{it}$, where α, β_1, β_2, and β_3 are the coefficients to be estimated .We test the hypothesis that β_2 and β_3 independently are equal to zero as well as investigate whether they are jointly equal to zero. We do the latter by estimating the model with the restriction that $\beta_2 = \beta_3 = 0$ (Model 2) and performing a maximum likelihood ratio test. The results of this estimation are presented below.

Table 8: Structural Break Regressions Results: Random Effects Logit

	Coef.	Std. Err.	z	P>|z|
my_w	.0648	.0034	19.01	0.000
Dummy	.2313	1696	1.36	0.173
Dummy·my_w	.0009	.0048	0.19	0.848
Constant	.0658	.1979	0.33	0.739

N = 4811, Log likelihood = -1483.48, Prob > chi2 = 0.0000,

Log Likelihood Model 1 = -1483.48,

Log Likelihood model 2 = -1485.46,

chi2(2) =3.96, prob > 0.1373

As we can see, the result are consistent with the hypothesis that moving from a deterministic to a stochastic discounting regime after period 6 did not have any statistically significant impact of acceptance or rejection behavior. The β_2 and β_3 coefficients are both insignificantly different from zero indicating that there is no structural break in the acceptance function at period 6. In addition, the likelihood ratio test also indicates that β_2 and β_3 are jointly insignificantly different from zero.

In short, this regression lends support to the idea that our method of insuring a finite number of periods of play in our infinitely repeated game did not alter the behavior of our subjects at the point where discounting became stochastic.

6 Conclusions

This paper has investigated the motives for reciprocal behavior in an infinitely repeated veto game. In such games, in each of an infinite number of periods, Nature generates a pair of payoffs, one for each player. Although the sum of the players' payoffs is positive, with positive probability one of the players receives a negative payoff. In each period each pair member is asked to approve or reject the payoff pair. If both subjects accept the they receive the payoffs proposed, if one or more reject they both get zero. Clearly reciprocity in this game entails being willing to accept negative payoffs today with the hope that such generosity will be reciprocated in the future.

We consider this game to be a good vehicle to study reciprocity because the rationale for reciprocal behavior is obvious and the game is simple, despite the fact that it is infinitely repeated. Following Cabral (2005) we designed an experiment whose purpose was to allow us to identify which one of two possible sources of reciprocity, intrinsic or instrumental, were most responsible for subject behavior.

Using some newly developed techniques to conduct infinitely repeated games, our data supports the notion that in this infinitely repeated game context, subject behavior is better described by theories of instrumental reciprocity but only to the extent that such reciprocity is part of a forward looking long run self-serving strategy. This is in distinction to intrinsic theories of reciprocity where reciprocal behavior is backward looking and exists to reward or punish previous kindness or unkindliness.

Finally, our results are consistent with the theory of veto games as presented in Cabral (2005) where optimal equilibrium behavior is characterized by a threshold for one's own payoff below which all offers are rejected but above which all offers are accepted regardless of the offer made to one's pair member.

References

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Tables 4a-4d: Thresholds

Table 4a: Thresholds - Treatment 1 Fixed matching Low Information

Subject	Max Threshold	Min Threshold	Mean Threshold	# of points unexplained	% of points unexplained
1	-9	-11	-10	1	1.0
2	-9	-9	-9	2	1.8
3	-83	-100	-91.5	6	5.8
4	-1	-8	-4.5	3	3.0
5	-6	-6	-6	2	2.3
6	-15	-29	-22	37	38.1
7	-27	-27	-27	6	5.8
8	-8	-8	-8	4	4.7
9	11	-21	-5	15	19.2
10	-42	-43	-42.5	7	5.3
11	2	-2	0	2	1.5
12	-35	-42	-38.5	3	3.1
13	-4	-10	-7	2	2.3
14	-19	-23	-21	4	4.1
15	-4	-4	-4	5	6.4
16	0	-1	-0.5	5	3.7
17	-43	-45	-44	13	9.9
18	-18	-26	-22	5	4.6
19	-13	-15	-14	0	0.0
20	-31	-38	-34.5	6	6.2
21	0	-1	-0.5	2	1.6
22	-97	-100	-98.5	16	19.5
23	4	3	3.5	2	2.2
24	-4	-12	-8	1	0.9
25	-17	-20	-18.5	3	3.1
26	2	-2	0	2	2.2
27	1	-1	0	0	0.0
28	-7	-17	-12	1	0.9
29	5	1	3	2	2.1
30	-18	-29	-23.5	6	7.3
Mean	-16.17	-21.53	-18.85	5.43	5.62
Median	-8.5	-13.5	-9.5	3.0	3.1

Table 4b: Thresholds - Treatment 2 Random matching High Information

Subject	Max Threshold	Min Threshold	Mean Threshold	# of points unexplaine	% of points unexplained
31	-16	-16	-16	10	8.7
32	-19	-41	-30	4	5.1
33	-30	-40	-35	6	6.6
34	2	-6	-2	10	9.3
35	-6	-26	-16	3	3.6
36	-14	-15	-14.5	4	3.6
37	-1	-3	-2	13	14.1
38	2	0	1	1	0.9
39	-70	-76	-73	18	15.5
40	0	-1	-0.5	1	0.9
41	-16	-21	-18.5	5	5.4
42	2	1	1.5	0	0.0
43	1	1	1	4	3.8
44	2	0	1	0	0.0
45	-7	-8	-7.5	2	2.1
46	2	-2	0	4	3.9
47	-14	-22	-18	14	12.1
48	3	1	2	2	2.0
49	-2	-2	-2	2	1.7
50	-7	-8	-7.5	9	8.7
51	-12	-14	-13	10	9.6
52	-7	-7	-7	4	4.3
53	-8	-40	-24	7	7.9
54	-33	-51	-42	11	10.8
55	-10	-10	-10	6	6.7
56	-3	-31	-17	15	17.0
57	9	6	7.5	1	1.1
58	-8	-10	-9	1	1.2
Mean	-9.29	-15.75	-12.52	5.96	5.95
Median	-7.00	-9.00	-8.25	4.00	4.69

Table 4c: Thresholds - Treatment 3 Fixed matching High Information

Subject	Max Threshold	Min Threshold	Mean Threshold	# of points unexplained	% of points unexplained
59	6	-4	1	6	5.5
60	-37	-58	-47.5	8	9.3
61	-6	-34	-20	20	19.6
62	-6	-19	-12.5	21	23.1
63	-31	-31	-31	8	9.3
64	-4	-10	-7	3	3.3
65	-19	-26	-22.5	1	1.0
66	-95	-96	-95.5	3	3.2
67	0	-5	-2.5	0	0.0
68	-10	-17	-13.5	2	2.0
69	-5	-13	-9	9	11.7
70	2	-1	0.5	3	2.8
71	3	-5	-1	2	2.0
72	0	0	0	1	1.1
73	4	-2	1	0	0.0
74	-10	-14	-12	4	4.1
75	-99	-100	-99.5	2	2.1
76	-2	-19	-10.5	4	3.9
77	-54	-57	-55.5	12	11.3
78	-18	-18	-18	6	7.8
79	-7	-7	-7	2	2.2
80	0	0	0	7	6.4
81	-13	-13	-13	21	20.2
82	-38	-53	-45.5	6	5.0
83	4	-2	1	2	1.9
84	-83	-83	-83	4	3.3
85	-2	-5	-3.5	0	0.0
86	5	5	5	2	2.2
87	0	-5	-2.5	6	7.1
88	-3	-4	-3.5	3	2.9
89	-1	-1	-1	1	1.0
90	6	1	3.5	6	6.6
Mean	-16.03	-21.75	-18.89	5.47	5.68
Median	-4.50	-11.50	-8.00	3.50	3.32

Table 4d: Thresholds - Treatment 4 Random matching Low Information

Subject	Max Threshold	Min Threshold	Mean Threshold	# of points unexplaine	% of points unexplained
91	-6	-17	-11.5	6	7.4
92	3	-4	-0.5	4	4.1
93	-13	-22	-17.5	2	2.4
94	-19	-35	-27	3	3.1
95	0	-1	-0.5	1	1.1
96	5	-1	2	1	1.4
97	4	-1	1.5	1	1.2
98	5	4	4.5	3	2.8
99	100	100	100	25	26.9
100	-18	-35	-26.5	1	1.1
101	-1	-4	-2.5	6	5.5
102	1	-2	-0.5	0	0.0
103	-19	-25	-22	2	2.1
104	5	-10	-2.5	3	3.4
105	-11	-12	-11.5	4	3.8
106	-10	-15	-12.5	5	4.0
107	-16	-25	-20.5	5	5.3
108	-3	-5	-4	2	1.9
109	-10	-12	-11	2	2.8
110	-1	-4	-2.5	2	1.9
111	-8	-9	-8.5	0	0.0
112	12	6	9	0	0.0
113	-4	-7	-5.5	1	1.3
114	3	-2	0.5	20	19.8
115	-3	-4	-3.5	2	2.8
116	1	-1	0	0	0.0
117	0	0	0	0	0.0
118	-17	-22	-19.5	4	4.7
119	-15	-15	-15	4	4.3
120	-5	-6	-5.5	0	0.0
121	-19	-28	-23.5	5	6.2
122	9	-4	2.5	1	1.1
123	-11	-19	-15	24	24.5
124	100	100	100	40	45.5
125	-15	-15	-15	4	3.1
126	-40	-42	-41	15	17.9
127	13	1	7	1	1.2
128	-38	-42	-40	6	6.3
129	-4	-22	-13	11	12.0
130	2	-4	-1	1	1.3
131	-6	-10	-8	2	2.2
132	-19	-41	-30	12	10.3
Mean	-1.62	-7.43	-4.52	5.50	5.87
Median	-4.00	-8.00	-5.50	2.50	2.80

Tables 5a-5d: Logit Acceptance Functions

Table 5a: Logit Regressions Treatment 1: Fixed Matching Low information

Format: coefficient / standard error — * = significant at 5%, ** = significant at 10%

Subject	my_w	opp_w	opp_kindness	_cons	# observations	Pseudo R^2
2	0.076*	0.012	-0.405	-0.404	109	0.67
	0.020	0.016	0.474	0.753		
3	0.106*	0.093*	-1.971	-0.121	104	0.37
	0.048	0.046	1.291	0.792		
4	0.195*	0.035	0.267	-0.020	101	0.88
	0.067	0.029	0.849	1.700		
5	0.506	0.251	0.234	3.046	88	0.90
	0.331	0.041	0.676	3.195		
6	0.067*	0.082*	0.081	-1.785*	97	0.43
	0.017	0.017	0.308	0.610		
7	0.145*	0.064*	-0.198	0.645	104	0.76
	0.040	0.028	1.368	1.077		
8	0.090*	0.019	-0.605	-0.581	85	0.59
	0.024	0.015	0.606	0.830		
9	0.050*	0.023	-0.265	-1.570	78	0.23
	0.016	0.012	0.327	0.679		
10	0.048*	-0.009	-0.177	3.040*	131	0.55
	0.018	0.021	0.462	1.191		
11	0.256*	-0.027	0.059	3.142	135	0.93
	0.115	0.032	0.334	3.088		
12	0.104*	-0.012	-0.292	4.642*	97	0.65
	0.041	0.030	1.015	2.280		

Subject	my_w	opp_w	opp_kindness	_cons	# observations	Pseudo R^2
14	0.116*	0.029	-0.902	-0.350	97	0.73
	0.029	0.020	1.223	0.895		
15	0.066*	0.025**	0.257	-1.525	78	0.57
	0.017	0.014	0.624	0.785		
16	0.075*	0.016	-0.320	-1.195	135	0.66
	0.016	0.012	0.427	0.740		
17	0.119*	0.058	0.254	1.797	131	0.65
	0.031	0.028	0.599	1.008		
18	0.541*	0.263**	1.059	-3.774**	109	0.93
	0.272	0.151	1.257	2.138		
20	0.851*	-0.106*	1.304	11.845*	97	0.82
	0.034	0.052	0.920	4.430		
21	0.076*	0.007	-0.018	-0.204	126	0.62
	0.018	0.013	0.178	0.772		
22	0.026*	0.027*	-0.305	0.500	82	0.08
	0.013	0.012	0.398	0.490		
23	0.243*	-0.046	0.331	2.175	91	.90
	0.097	0.041	0.923	2.560		
25	0.165*	0.037	-0.773	-0.132	97	.79
	0.063	0.040	0.525	2.181		
26	0.118*	0.024	0.822	-1.014	91	0.79
	0.040	0.025	0.807	1.346		
30	0.102*	0.031	1.263	0.393	82	0.74
	0.030	0.021	0.945	0.947		

Table 5b: Logit Regressions Treatment 2: Random Matching High information

Subject	my_w	opp_w	opp_kindness	cons	# observations	Pseudo R^2
31	0.069*	0.037*	-0.265	-0.893	115	0.36
	0.017	0.013	0.258	0.553		
32	0.076*	0.027	-1.285	-0.382	78	0.53
	0.029	0.022	1.115	1.129		
33	0.075*	-0.006	0.106	2.689	91	0.68
	0.026	0.023	0.605	1.406		
34	0.070*	0.033*	-0.362**	-1.892*	107	0.41
	0.017	0.012	0.203	0.658		
35	0.157*	0.015	3.541**	3.343	84	0.83
	0.070	0.037	1.972	2.881		
36	0.147*	-0.011	0.553	4.014	111	0.82
	0.048	0.024	0.395	2.191		
37	0.051*	0.029*	-0.027	-1.031*	92	0.28
	0.014	0.011	0.295	0.535		
39	0.038*	-0.012	1.448*	3.266*	116	0.56
	0.016	0.014	0.437	0.871		
41	0.481*	0.081	6.428	6.916	93	0.91
	0.221	0.070	4.693	6.864		
43	0.075*	-0.004	0.056	1.737	104	0.74
	0.021	0.019	0.463	1.120		

Subject	my_w	opp_w	opp_kindness	cons	# observations	Pseudo R^2
45	0.264*	0.023	0.162	1.893	94	0.86
	0.112	0.027	0.326	1.579		
46	0.080*	0.001	0.589	0.338	103	0.74
	0.026	0.016	0.456	0.850		
47	0.054*	0.001	1.858*	2.137*	116	0.61
	0.014	0.015	0.576	0.829		
48	0.186*	0.022	-1.326	-2.377	101	0.84
	0.067	0.021	1.056	1.552		
49	0.130*	-0.021	0.423	1.435	121	0.80
	0.036	0.017	0.595	0.990		
50	0.085*	-0.017	0.600	1.906*	104	0.72
	0.024	0.017	0.610	0.929		
51	0.065*	0.042*	0.315	-0.044	104	0.30
	0.019	0.017	0.332	0.502		
52	0.137*	0.046**	1.078*	0.601	94	0.71
	0.047	0.026	0.505	0.972		
53	0.099*	0.034**	0.901	1.496	89	0.71
	0.025	0.020	0.480	1.101		
54	0.048*	0.001	-0.072	1.791*	102	0.39
	0.015	0.015	0.353	0.796		
55	0.089*	-0.013	1.261*	2.606	89	0.69
	0.029	0.019	0.587	1.461		
56	0.063*	0.051*	0.069	-1.272*	88	0.35
	0.013	0.013	0.333	0.516		
57	0.103*	-0.021	0.052	0.840	92	0.81
	0.032	0.021	1.264	1.269		

Table 5c: Logit Regressions Treatment 3: Fixed Matching High information

Subject	my_w	opp_w	opp_kindness	cons	# observations	Pseudo R^2
59	0.062*	0.013	-0.160	-0.763	110	0,51
	0.017	0.012	0.212	0.325		
60	0.080*	0.071*	-0.623	-0.441	86	0.29
	0.028	0.027	0.657	0.657		
61	0.062*	0.050*	-0.113	-1.224*	102	0.24
	0.015	0.013	0.175	0.581		
62	0.047*	0.033*	0.382	-0.645	91	0.19
	0.013	0.011	0.266	0.538		
63	0.122*	0.078*	-1.383	-1.418	86	0.62
	0.031	0.025	1.212	0.738		
65	0.264	-0.021	0.510	6.515	101	0.92
	0.170	0.050	1.794	3.788		
66	0.435	0.398	0.434	-0.788	95	0.69
	0.263	0.256	0.586	1.871		
69	0.025	-0.039*	0.439	0.836	77	0.65
	0.020	0.020	0.608	0.952		
70	0.174*	0.015	-0.286	-0.551	106	0.78
	0.056	0.021	0.519	1.186		
72	1.942	0.106	-4.374	-11.981	89	0.95
	2.621	0.202	7.032	21.375		
74	0.084*	-0.039	-0.346	4.077*	98	0.77
	0.025	0.026	0.711	1.872		

Subject	my_w	opp_w	opp_kindness	_cons	# observations	Pseudo R^2
75	0.024	-0.107	2.393	13.980	95	0.37
	0.038	0.128	2.680	11.406		
76	0.260*	0.018	-2.819	0.556	102	0.90
	0.093	0.027	1.901	1.655		
77	0.062*	0.017	-0.142	1.326	106	0.52
	0.019	0.020	0.265	0.823		
78	0.084*	0.009	0.162	0.806	77	0.70
	0.025	0.018	0.644	0.943		
79	0.083*	-0.000	0.435	0.860	89	0.71
	0.023	0.017	1.063	0.890		
80	0.072*	0.014	-0.106	-0.271	110	0.62
	0.017	0.014	0.335	0.822		
81	0.072*	0.052*	-0.187	-2.115*	104	0.30
	0.016	0.012	0.176	0.626		
82	0.194*	0.042	2.796*	2.341	120	0.76
	0.074	0.038	1.287	1.657		
83	0.114*	-0.012	-0.470	-0.586	105	0.73
	0.033	0.016	0.370	1.007		
84	0.137*	-0.053	-1.085	14.821**	120	0.76
	0.053	0.092	1.026	7.840		
86	0.087*	-0.040**	-0.112	1.679	91	0.83
	0.032	0.023	0.775	1.443		
87	0.060*	0.016	0.069	0.222	84	0.51
	0.016	0.015	0.419	0.722		
88	0.174*	-0.008	0.910	0.857	105	0.87
	0.055	0.023	0.902	1.175		
89	0.237*	0.037	-0.802	-2.134	104	0.91
	0.097	0.037	1.136	2.427		
90	0.046*	-0.023	0.481	1.768*	91	0.56
	0.015	0.015	0.363	0.886		

Table 5d: Logit Regressions Treatment 1: Random Matching Low information

Subject	my_w	opp_w	opp_kindness	cons	# observations	Pseudo R^2
91	0.072*	0.022	1.117	1.266	81	0.60
	0.021	0.019	0.802	0.944		
92	0.107*	0.023	-0.012	-0.496	98	0.73
	0.033	0.022	0.268	0.949		
93	0.532	0.180	1.002	-0.968	82	0.88
	0.466	0.174	2.221	2.589		
94	0.755	0.289	-0.288	1.464	98	0.90
	0.521	0.217	0.611	1.920		
98	0.137*	-0.004	0.250	-0.507	108	0.76
	0.039	0.015	0.517	1.033		
99	0.069*	0.067*	0.003	-3.914*	93	0.35
	0.015	0.014	0.415	0.774		
101	0.094*	0.031**	0.549	-0.908	110	0.68
	0.023	0.016	0.401	0.863		
103	0.258*	0.014	-0.417	3.210	95	0.92
	0.131	0.055	2.168	2.239		
104	0.159*	0.009	-1.707	-1.329	87	0.85
	0.054	0.023	1.157	1.539		

Subject	my_w	opp_w	opp_kindness	_cons	# observations	Pseudo R^2
105	0.079*	0.023	0.408	0.351	105	0.66
	0.019	0.015	0.394	0.799		
106	0.109*	0.039*	-0.207	-1.028	125	0.67
	0.025	0.016	0.317	0.831		
107	0.074*	0.013	-0.210	0.793	95	0.65
	0.019	0.019	0.609	0.974		
108	0.229*	0.010	-0.179	0.470	106	0.90
	0.105	0.031	0.980	2.062		
110	0.115*	-0.000	-0.667	0.571	103	0.82
	0.039	0.021	0.958	1.040		
114	0.050*	0.030*	0.514*	-0.334	101	0.22
	0.013	0.011	0.176	0.460		
115	0.113*	-0.010	0.858	2.432	72	0.74
	0.044	0.025	0.854	1.834		
118	0.109*	0.035	-4.600	-0.267	85	0.65
	0.036	0.024	2.935	1.275		
119	0.094*	0.033	0.443	0.312	93	0.68
	0.029	0.021	0.339	0.867		

Subject	my_w	opp_w	opp_kindness	_cons	# observations	Pseudo R^2
121	0.109*	-0.024	1.843	5.197*	81	0.82
	0.038	0.028	1.340	2.433		
123	0.070*	0.054*	0.009	-2.425*	98	0.34
	0.014	0.011	0.401	0.582		
124	-0.004	-0.003	-0.192	-0.268	88	0.01
	0.008	0.009	0.217	0.421		
125	0.131*	-0.013	0.024	3.236*	130	0.80
	0.036	0.020	0.591	1.389		
126	0.048*	0.033*	0.676**	-0.466	84	0.28
	0.012	0.011	0.386	0.452		
127	0.374	0.033	0.161	-1.948	82	0.96
	0.240	0.040	2.326	4.287		
128	0.101*	0.025	1.065	2.632*	95	0.73
	0.033	0.026	0.744	1.320		
129	0.048*	0.018	-0.326	-0.619	92	0.46
	0.013	0.013	0.483	0.566		
130	0.117*	-0.006	1.238	1.301	75	0.84
	0.042	0.028	1.036	1.835		
131	0.086*	-0.015	0.554	1.928	90	0.77
	0.033	0.026	1.024	1.708		
132	0.058*	0.019	0.231	0.634	116	0.46
	0.012	0.012	0.683	0.623		

7 Appendix

Proof of Proposition: We first prove that any optimal equilibrium must have the property that $x_i^C(w_i, w_j) = 1$ if and only if $w_i \geq -\ell_i$. Next we show that there is a unique optimal equilibrium with this property. Finally, in the section below, which demonstrates how to derive the optimal ℓ, we demonstrate how ℓ varies with the Nash threat assumed in the punishment phase.

Consider two points in the second quadrant (that is, where $w_1 > 0$ and $w_2 < 0$): $A = (w_1^A, w_2^A)$ and $B = (w_1^B, w_2^B)$. Suppose that $w_2^A > w_2^B$, $x_2(w_1^A, w_2^A) = 0$ and $x_2(w_1^B, w_2^B) = 1$. In other words, player 2 approves proposal B but vetoes proposal A, even though proposal A gives player 2 a higher payoff. If this were an equilibrium, then player 2's no-deviation constraint must be met at point B. But then it must also be met at point A. It follows that, by choosing $x_2(w_1^A, w_2^A) = 1$ instead, we get an alternative equilibrium with a higher sum of joint payoffs—a contradiction.

The above argument implies that players' strategies must take the form $x_i^C(w_i, w_j) = 1$ if and only if $w_i \geq -\ell_i$. It also implies that the no-deviation constraint, $w_i + \frac{\delta}{1-\delta} E_i \geq \frac{\delta}{1-\delta} N_i$, is exactly binding when $w_i = -\ell_i$:

$$-\ell_i + \frac{\delta}{1-\delta} E_i = \frac{\delta}{1-\delta} N_i, \tag{1}$$

Finally, it also implies that equilibrium payoff for player i is given by

$$E_i \equiv \int_{\substack{w_i \geq -\ell_i \\ w_j \geq -\ell_j}} w_i f(w)\, dw - \int_{\substack{w_i \geq 0 \\ w_j \geq 0}} w_i f(w)\, dw.$$

Notice that E_i is increasing in ℓ_j and decreasing in ℓ_i.

We now show that there exists a unique efficient equilibrium, that is, one that maximizes joint payoffs. Suppose there were two such equilibria, corresponding to threshold levels (ℓ_i', ℓ_j') and (ℓ_i'', ℓ_j'') and leading to equilibrium payoffs (E_i', E_j') and (E_i'', E_j''), respectively. Without loss of generality, assume $E_i'' \geq E_i'$ and $E_j' \geq E_j''$.

Equation (1) and $E_i'' \geq E_i'$ imply $\ell_i' \leq \ell_i''$. By a similar argument, $\ell_j' \geq \ell_j''$. Since E_i is increasing in ℓ_j and decreasing in ℓ_i, this implies that $E_i'' \leq E_i'$. Given our starting assumption that $E_i'' \geq E_i'$, we conclude that $E_i'' = E_i'$, and so $\ell_i' = \ell_i''$. By a similar argument, we also conclude that $E_l'' = E_l'$ and $\ell_j' = \ell_j''$. ■

◊ Derivation of equilibrium ℓ: First we compute the value of π^N, equilibrium payoff in the static Nash game. Recall that there are two types of Nash equilibrium. In the weakly dominant strategy one (a player accepts a proposal if and only if his payoff is positive):

The area of the region where $w_i \geq 0$, for both i, is given by

$$\int_0^{100} x\,(100 - x)\,dx = \frac{500,000}{3}. \tag{2}$$

Straightforward calculations show that the total area of the set of proposals is given by 15,000. Since the distribution of w is uniform over this set, it follows that π^N is given by (2) divided by 15,000, or simply

$$\pi^N = \frac{100}{9}.$$

In the class of Nash equilibria in which any offer is rejected, the payoff of each player is equal to 0.

The next step is to compute the value of π^E, payoff along the repeated game efficient equilibrium path. The area of the shaded region in Figure 4 is given by

$$\int_{-\ell}^{0} x\,(100 - (-x))\;dx + \int_0^{\ell} x\,(100 - x - (-x))\;dx + \int_{\ell}^{100} x\,(100 - x - (-\ell))\;dx,$$

or simply

$$\frac{2}{3}\,\ell^3 - \frac{1,000,000}{3} + \frac{1}{2}\,(100 + \ell)(10,000 - \ell^2). \tag{3}$$

It follows that π^E is given by (3) divided by 15,000, or simply

$$\pi^E = \frac{\ell^3}{22500} - \frac{200}{9} + \frac{(100 + \ell)(10000 - \ell^2)}{30000}.$$

Given the values of π^E and π^N, we can now derive the equilibrium value of ℓ by making the no-deviation inequality binding. We thus have

$$\ell + \delta\,\pi^E/(1 - \delta) = 0 + \delta\,\pi^N/(1 - \delta).$$

If the players use their weakly dominant strategy as a threat, first note that zero is a root. In fact, if $\ell = 0$, then $\pi^E = \pi^N$ and the no-deviation constraint holds trivially. Hence, we are left with a quadratic equation with the roots: $150 \pm 50\sqrt{36/\delta - 39}$, and it can easily be shown that only one of the roots (potentially) lies in the relevant interval, $[-100, 0]$. We thus have

$$\ell = 150 - 50\,\sqrt{36/\delta - 39}.$$

Solving for $\ell < 0$, we get $\delta > \frac{3}{4}$. Solving for $\ell > -100$, we get $\delta < .9$. So finally we have

$$\hat{\ell} = \begin{cases} 0 & \text{if} \quad \delta < .75 \\ -150 + 50\sqrt{36/\delta - 39} & \text{if} \quad .75 \leq \delta \leq .9 \\ -100 & \text{if} \quad \delta > .9 \end{cases}$$

In particular, $\delta = .8$ (parameter in the experiment) implies $\hat{\ell} = -27.53$.

If any offer is rejected as a punishment strategy, then $\ell + \delta\,\pi^E/(1-\delta) = 0$ and again only one root lies in $[-100, 0]$. When $\delta = .8$ implies $\hat{\ell} = 88.83$. Hence, any $\hat{\ell}$ between 27.53 and 88.83 can be sustained in the equilibrium. Since the sum of the offers are always positive, the efficient equilibrium is achieved when $\hat{\ell} = 88.83$.

Instructions: Random Matching High Information

This is an experiment in decision making. Money has been provided for this experiment by various research foundations. You will be paid for your participation and if you make good decisions you may be able to earn a substantial amount of money that will be paid to you when the experiment is over.

The Experiment.

You have been recruited to participate in this experiment along with a number of other people who are in the room with you. When the experiment starts you will be paired with one person in the room at random. This person will be your pair member for the rest of the experiment. The experiment will consist of 10 rounds with each round consisting of a random number of periods. While the number of periods will be random, there will always be at least 6 in any round. After period 6 is over in any given round, whether you proceed to the next period will be determined randomly as will be described below. So in any round you will play 6 periods for sure and maybe more.

When Round 1 starts you and your pair member will be shown a computer screen upon which two numbers will be shown, one indicating a potential payment to you and one a potential payment to your pair member. These payments are denominated in a fictitious experimental currency called francs which will be converted at the end of the experiment at a rate of 1 franc = 0.6 cents. The numbers will be drawn at random but all the pairs of numbers you will see will have the same two properties:

1)Each payment to each pair member will be independently chosen from the interval [-100, +100].

In other words, you will never see a number outside this range, and within this range each number will have an equally likely chance of being chosen, so there will be an equal chance that your number is –20 as it will be +85 as it will be –99, or +42 etc.

2)The sum of the numbers must be positive and less than 100.

This means that when the computer draws a number for you and your pair member and adds them up, if the sum is negative or greater than 100 the computer will throw that pair of numbers away and pick another. You will only see pairs whose sum is positive and less than 100.

When the payment pairs are drawn you will see a screen that says:

Your franc payment _________

Your pair member's franc payment ______

And you will be asked to approve or refuse the payments. If you approve you must click the approve button at the bottom of the screen; if you refuse, click the refuse button.

If both subjects approve the payment pair, you will both receive that amount indicated as a payment for the period. If either of you refuse, you both will receive nothing during that period.

When period 1 is over, you will be shown the results of that period by being informed of what your pair member chose (accept or refuse) and your payoff . We then proceed directly to period 2, which will be identical to period 1, that is, you will be shown a new randomly drawn payment pair and asked to accept or refuse. When period 2 is over you will be shown the results of that period and also your cumulative payoff up until that period and then proceed to period 3. This will happen for 6 periods. After the 6th period, the computer will randomly determine whether you move to period 7. It does this by flipping a coin that has a .80 chance of landing heads and a .20 chance of landing tails. If the coin lands heads, we proceed to period 7 and repeat the procedures above; and at the end the computer randomly determines whether we move to period 8. This will continue until the computer determines that you will not proceed to any more periods. When that is determined the computer will notify you that you will now be playing the last period in this round by announcing that **"This is the Last Period in this Round".** After you finish that period the current round of the experiment will end. In other words, you will be told when you are playing the last period in any round. When the round is over, you will be shown your payoffs for that round, proceed to the Round 2 and repeat the experiment identically. There will be 10 rounds in the experiment, but as you have seen, each round may have a different number of periods, depending on chance.

As stated above, all of the above payments will be denominated in a fictitious experimental currency called francs. At the end of the experiment, your payment will be converted into US dollars at the rate of 1 franc = 0.6 cents.

There is only one detail left to be explained: Within the first 6 periods of any round of the experiment, the periods we know we will play for sure, the number of francs you will receive when you accept a proposed payment pair will vary. More precisely we will multiply your displayed franc payoff by a "multiplier" depending upon the period the payoff is accepted (your pair member's franc payoff will also be multiplied by this number as well). The set of multipliers used is shown in Table 1 below:

Period Multipliers

Period	**Multiplier**
1	3.05
2	2.44
3	1.95
4	1.56
5	1.25
6	1.00
7+	1.00

To illustrate what this table says, say that in period 1 of any round you and your pair member agree to a payoff pair that gives you a franc payoff of 20. In such a case instead of you being credited with 20 francs as your payment you would be credited with 20 x 3.05 = 61, where 3.05 is the multiplier associated with period 1 in the table above. If you agreed to the same payoff in period 5 you would be credited with 20 x 1.25 = 25, where 1.25 is the period-5 multiplier. Note that the multipliers decrease as we approach period 6, the last period you will engage in for sure, where the multiplier is equal to 1. It will remain equal to 1 for all succeeding periods; but, as we have explained above, in all succeeding periods the probability of continuing is equal to .8.

Final Payoffs:

Your final payoff in the experiment will be the sum of your earning over the 10 rounds of the experiments. That means that we will sum your franc payoffs earned in each round of the experiment and then convert them into U.S. dollars at the rate of 1 franc = 0.6 cents.