Appendix: Instructions for the Baseline Treatment

This is an experiment in decision-making. If you follow the instructions and make good decisions, you can earn a substantial amount of money, which will be paid to you at the end of the session. The currency in this experiment is called tokens. All payoffs are denominated in this currency. The experiment consists of **20 identical decision rounds.** At the end of the experiment, we will sum up the tokens you earned in all 20 rounds and this amount will be converted into US dollars using a conversion rate of 10 tokens = $1. In addition, you will receive a participation fee.

Before the beginning of the experiment you will be randomly assigned roles: $\frac{2}{3}$ of the participants will be assigned a role of **investors** and $\frac{1}{3}$ of participants will be assigned a role of **lenders**. The role of an investor will be to invest an "investment chip" if one given to him by the lender, while the role of the lender will be to decide whom to given his investment chip to. Roles stay fixed until the end of the experiment. That is, if at the beginning of the experiment you were assigned the role of an investor (lender) you will keep this role for all 20 rounds.

In each round, participants will be randomly matched into the groups of 3 people. Each group consists of two investors and one lender. Once the round is over, you will be re-matched with other participants for the next round. However, there will always be two investors and one lender in every group. The investors will receive a participation fee of $10 and lenders will receive a participation fee of $5.

Decision of the investors in each period.

Each period starts with the lender being given one chip which he/she will lend to one of the investors in their group. This chip has no value other than providing the right to get a return if it is invested, i.e. it cannot be converted to tokens. Investors are the ones who decide how a chip received from the lender is invested and how many tokens the lender will receive if the investment is successful.

There are two investment projects: Project 1 and Project 2, which differ in the returns and the probability of defaulting:

- **Project 1** pays back 10 tokens with probability 50% and 0 tokens with probability 50%.
- **Project 2** pays back 7 tokens with probability 90% and 0 tokens with probability 10%.

In other words, **Project 1** has a return of 10 tokens and 50% probability of defaulting. **Project 2** has return of 7 tokens and 10% probability of defaulting.

Each period starts with the investors making two decisions. First, each Investor chooses how many tokens he is willing to pay to the lender that lends him his/her chip in case the investment is successful. Second, each investor chooses a Project in which the chip received from the lender will be invested. The number of tokens that the investor can pay the lender for a chip can be any number between 0 and 10 tokens with one digit after decimal, i.e. numbers like 3.2, 4.6, 5.9, 8.6 etc... This number represents how many tokens an investor will pay the lender that lends him his/her chip in case the project in which this chip was invested was successful. If the project in which the chip was invested defaulted, then both the investor and the lender get zero tokens. Each investor makes his/her choice without knowing what the other investor from his group chose.

Decision of lenders in each period.

After both investors make their choices, the lender observes how many tokens each investor promises to pay to the lender that gives him his chip. The lender's task is to choose which investor he/she is willing to lend his chip to. Notice that lenders do not observe which project the investor chose to invest in (project 1 or 2); they observe only the promises of the investors in their own group. The screen for the lenders will look like this

Investor A promised to pay back x tokens
Investor B promised to pay back y tokens

It is important to note that in each round, the lender is matched with different investors. Therefore, it is impossible to track the same investor between periods. For instance, an investor who appears as Investor A in one round is not the same person as investor who appears as Investor A in the next round.

How the profits of the investors and the lender are determined.

In any period, an investor that did not receive a chip from the lender will receive zero tokens in that period.

If the investor who did receive a chip and promised to pay back x tokens, then

- if the project in which the chip was invested defaulted, both the investor and the lender get 0 tokens in that period
- if the chip was invested in Project 1 and did not default, then the investor gets $10 - x$ tokens in that period and the lender gets x tokens as promised.
- if the chip was invested in Project 2, did not default and $x \leq 7$, then the investor gets $7 - x$ tokens in that period and the lender gets x tokens as promised.

- if the chip was invested in Project 2, did not default and $x > 7$, then the investor gets 0 tokens in that period and the lender gets 7, which is less than what investor promised to him.

Quiz.

Question 1

Say an investor that received a chip from the lender promised to pay back 7.3 tokens, invested this chip in Project 1 and Project 1 did not default. What is the profit of the lender in this period? What is the profit of the investor that received the chip in this period? What is the profit of the other investor from the same group? What is the profit is each subject in a group if Project 1 defaulted?

Question 2

Say investor that received the chip from the lender promised to pay him back 4.9 tokens, invested this chip in Project 2, which did not default. What is the profit of the lender in this period? What is the profit of the investor that received the chip? What is the profit of the other investor from the same group?

Investor's feedback.

At the end of each period investors observe the following information: how many tokens he/she promised to pay back to a lender that lends him/her chip; how many tokens the other investor promised to pay back to lender; whether or not the investor received the chip from the lender; in case the investor received the chip from the lender, which project was the chip invested in and whether the project was successful or not; whether the investor was able to repay the lender what he promised and profits of the investor in tokens. You will not be told what project the other investor decided to invest in.

Lender's feedback.

At the end of each period the lender observes the following information: how many tokens each investor promised to repay to a lender that gives him his chip; which investor he/she chose to lend the chip to and whether this investor was able to repay the promised return or not. The lenders are also informed about how many tokens they received in this period.

To summarize:

- At the beginning of the experiment, subjects are assigned roles of investors and lenders, which they keep for the whole duration of the experiment.

- In each period subjects are divided into the groups of 3 people: two investors and one lender.
- Each period starts with the decision of investors as to how many tokens they promise to repay to a lender that gives him/her an investment chip and which project, 1 or 2, the chip received from the lender will be invested in.
- The lenders observe the promised returns and choose one investor in their group to lend chip to
- The chip received by an investor is then invested in the project of his/her choice as determined at the beginning of the period
- Payoffs are realized and all lenders and investors observe how many tokens they receive in this period
- At the end of the experiment all tokens earned in these 20 periods will be summed up and their sum converted to US dollars at a rate of 10 tokens = \$1. In addition, you will receive a participation fee.

Last part of the experiment.

In this part of the experiment we will ask you all to act as an investor for one period and make one investment decision with an investment chip which we will give you. Please choose whether you want to invest in Project 1 or Project 2:

- Project 1 pays back 10 tokens with probability 50% and 0 tokens with probability 50%
- Project 2 pays back 7 tokens with probability 90% and 0 tokens with probability 10%

After you made your decision, we will roll a 10-sided dice to determine whether the project you invested in defaulted or paid back. If you invested in Project 1 and dice lands on 0, 1, 2, 3 or 4 then Project 1 defaults and you get 0 tokens. If it lands on any number strictly above 4 (that is, 5, 6, 7, 8 or 9) then you get 10 tokens. If you invested in Project 2 and dice lands on 0 then Project 2 defaults and you get 0 tokens. If it lands on any other number (1, 2, 3, 4, 5, 6, 7, 8 or 9) then you will get 7 tokens.

Amount of tokens you earn in this part will be converted into US dollars, using the conversion rate 1 token = \$1, and added to your total payment.

Please circle the Project in which you want to invest your investment chip:

Project 1 Project 2