

Abstract: We investigate the effect of vertical wage dispersion, defined as the difference in wages between superiors and subordinates, on subordinates' behaviors in competition. We propose that higher vertical wage dispersion increases subordinates' desire to reduce the vertical pay gap through collusion against their superiors in a setting where collusion reduces subordinate effort while increasing subordinates' pay. Our two experiments test our prediction in one-shot (Study 1) and repeated (Study 2) tournament settings. In Study 1, we find that rather than increasing collusion, high vertical wage dispersion increases competitiveness and effort contribution. In Study 2, we find support for our prediction that high vertical wage dispersion increases collusion and reduces effort contribution due to the trust building between subordinates that is facilitated by repeated tournaments. We contribute to the growing research on pay dispersion by studying how vertical wage dispersion affects lower-level employees' interaction with their peers. We also extend tournament research by studying how a contextual variable outside the tournament, i.e., *ex ante* vertical wage dispersion, could affect employees' willingness to compete or to collude in tournaments. An implication of our finding is that high vertical wage dispersion may make competitive incentives more or less effective, depending on the context.