What happens when there is a context in bargaining?

**Self-Serving Bias and Bargaining Impasse:**
Babcock, Loewenstein, Isacharoff and Camerer: AER ’95

Consider Bargaining followed by an enforced division in case of disagreement: This mimics bargaining over out of court settlements followed by a judges’ decision in case of disagreement.

**Claim:** The reason parties fail to reach agreement is not (only) due to incomplete information (about the other parties’ reservation value, the judges’ decision). The parties will reach different estimates on the judges’ decision due to self-serving bias.

**Aim:** Test whether self-serving bias has an effect on bargaining impasse. Therefore: Manipulate the magnitude of self-serving bias and examine the effect on settlement behavior.

**The Experiment:**
Subjects received 27 pages of case material abstracted from an actual Texas court case: A dispute for damages resulting from a motorcycle-vehicle accident. The plaintiff (motorcyclist) is suing the defendant (automobile driver) for $100,000. The two parties are given the same information (common knowledge) and an actual judge in Texas decided how much to award to the plaintiff.
After reading the case, but before negotiating:
(i) What do they think is fair
(ii) Best guess of the amount the judge would award.

Incentive Compatibility: Receive $1 if their estimate is within $5.000 of the judges award.

Payoffs of negotiation:
$10.000 ~ $1. Defendant at the beginning receives $10 (~ $100.000) out of which he paid plaintiff.

Negotiation:
Six 5. min. periods: At the end: submit simultaneous bids. If bids overlap, they settle at the midpoint. If bids do not overlap each pays $0.5 (~ $5.000) “lawyers’ fee”. If they do not reach agreement in the 6. period: Judge imposes settlement and each pays legal fees of $ 2.5 (~ $ 25.000). (His ruling: $30.560)

Subjects: 94 pairs students.

Manipulation of Self-Serving Bias:
Condition A:
Subjects learn their role. Then read case material, assess fair settlement, predict judges’ award, negotiate.
Condition B:
Subjects read case material, assess fair settlement, predict judges’ award. Then subjects learn their role and negotiate.

Idea: Self-serving interpretations are likely to occur at the point when information about role is assimilated.
Results:

<table>
<thead>
<tr>
<th>A know role</th>
<th>Settlement rate</th>
<th>Avg. number of periods to settle</th>
<th>Mean Settlement</th>
</tr>
</thead>
<tbody>
<tr>
<td>A know role</td>
<td>0.72</td>
<td>3.75</td>
<td>$29.970</td>
</tr>
<tr>
<td>B don’t know</td>
<td>0.94</td>
<td>2.51</td>
<td>$36.762</td>
</tr>
<tr>
<td>p-values</td>
<td>&lt; 0.01</td>
<td>&lt; 0.01</td>
<td>&lt; 0.06</td>
</tr>
</tbody>
</table>

**Diff Fair**: difference between plaintiff’s and defendant’s assessment of a fair judgment.

**Diff Judge**: difference between plaintiff’s and defendant’s assessment of the judge’s award.

<table>
<thead>
<tr>
<th></th>
<th>Diff Fair</th>
<th>Diff Judge</th>
</tr>
</thead>
<tbody>
<tr>
<td>A: know role</td>
<td>$19.756*</td>
<td>$18.555*</td>
</tr>
<tr>
<td>B: don’t know</td>
<td>-$6.275</td>
<td>-$6.936</td>
</tr>
<tr>
<td>p-values</td>
<td>&lt; 0.01</td>
<td>&lt; 0.01</td>
</tr>
</tbody>
</table>

Does self-serving bias account for non-settlement?

<table>
<thead>
<tr>
<th></th>
<th>Do not Settle</th>
<th>Settle</th>
</tr>
</thead>
<tbody>
<tr>
<td>Diff Fair</td>
<td>$24.656</td>
<td>$3.066</td>
</tr>
<tr>
<td>Diff Judge</td>
<td>$31.875</td>
<td>$463</td>
</tr>
</tbody>
</table>

Differences are all significantly different from zero.

Probit Analysis (Probability of settlement):

The experimental manipulation variable “Did not know roles” becomes insignificant in explaining settlement, once Diff Fair or Diff Judge is added to the equation.
Reason for rich context:
This is more likely to produce self – serving bias than a generic context. The rich context provides multiple arguments, introducing the possibility of self serving bias by allowing subjects to focus on, or weight, differentially arguments favoring themselves over the other party.

Real World Application:
Babcock, Linda, Xianghong Wang and George Loewenstein, 1996, “Choosing the wring pond: Social Comparisons in negotiations that reflect a self-serving bias,” QJE.

The authors looked at wage bargaining of teachers across districts and found that districts in which neighboring districts had a high variance in wages were more likely to have strikes…

In those districts different parties focused on different reference points to determine what is fair behavior, and strike activity is positively related to the difference in the salary levels of the teacher unions’ and school boards’ lists of comparables.