

AGREEING TO DISAGREE:

THE VALUE OF 'JOINT OUTSIDE OPTIONS' IN NEGOTIATIONS

In many types of negotiation, the parties can 'agree to disagree' – that is, they can leave the current negotiations and switch, by common accord, to a different type of relationship. New research by Dr **Paola Manzini** and Professor **Marco Mariotti**, published in the October 2004 *Economic Journal*, shows that although one of the two negotiating parties may stand to lose from such a switch, the fact that it is an option may completely determine the negotiated outcome.

Many common situations exemplify how the availability of a 'joint outside option' is a potent strategic tool in negotiations:

- An employer and employee are locked in a long-term contract and are arguing over working conditions. 'Early retirement', which requires the consent of both parties, offers an alternative resolution of the conflict.
- A landlord and tenant are involved in a dispute. In case of a deadlock, they can at any time agree to have their argument resolved by an arbitrator.
- After getting married, both partners learn of attractive outside alternatives. Unilaterally filing for divorce is not viewed as a practicable (or even legal) option; instead, they can opt for a less costly consensual decision to split.
- Two siblings argue over how to share the use of their inherited country house. Should they fail to reach an agreement, they may agree to sell the house and share the proceeds.

In these very diverse situations, *exit is feasible only when agreed by both sides*. To analyse these situations, the researchers introduce the concept of a 'joint outside option' (J.O.O.). Formally, a J.O.O. is just like a standard outside option (that is, an alternative that can be obtained by the players if they leave the negotiations) with the single difference that it can only be obtained if *both* players consent to it.

One might think that if one of the parties is bound to lose from opting out compared to the outcome of negotiations without a J.O.O., and since both parties have veto power, the existence of a J.O.O. will be completely irrelevant, as the losing party will always exercise their veto. In fact, the strategic situation is more complex than that and a deeper analysis belies simple intuition.

The researchers find that the intuitive outcome described above is just one possibility. More surprisingly, they show that another possibility is for negotiators to agree on a negotiated settlement that yields precisely the same 'utility' as the J.O.O. That is, the veto power of the negotiator who stands to lose from taking the J.O.O. ('the Loser') may be merely apparent and have no value in practice.

The strategic force sustaining this situation is for the party who gains from the J.O.O. ('the Winner') to threaten never to accept a proposal yielding a lower utility than the J.O.O. would. They can back this up by proposing to call for the J.O.O. to be taken every time the Loser's

bargaining proposal is unsatisfactory.

In such a situation, the Loser can do no better than to accept a payoff equivalent to the J.O.O., given the Winner's stance. But then it would be irrational for the Loser even to begin asking for more than the J.O.O. payoff, incurring unnecessary and costly delays.

This type of outcome can occur even when the J.O.O. is not efficient – that is, when there are negotiable alternatives that both parties prefer to the J.O.O.: switching out of the current type of relationship in favour of a different one may be costly.

The researchers also show that by using more complex bargaining tactics, all the 'intermediate' divisions between the two just described are possible outcomes of the negotiations, and delays can occur.

ENDS

Note for Editors: 'Going Alone Together: Joint Outside Options in Bilateral Negotiations' by Paola Manzini and Marco Mariotti is published in the October 2004 issue of the *Economic Journal*.

The authors are in the Department of Economics, Queen Mary, University of London.

For Further Information: contact Paola Manzini on 020-7882-5083 (email: p.manzini@qmul.ac.uk); Marco Mariotti on 020-7882-5093 (email: m.mariotti@qmul.ac.uk); or RES Media Consultant Romesh Vaitilingam on 0117-983-9770 or 07768-661095 (email: romesh@compuserve.com).