

Excerpts from

The Science of Settlement

Barry Goldman

§3.01(a) Anchoring

In a mock jury experiment conducted by Reid Hastie and colleagues, plaintiffs suggested either an award “in the range between \$15 million and \$50 million” in one condition or “in the range from \$50 million to \$150 million” in the other. Everything else was the same in both experimental conditions, and in both conditions the judge told the jurors, “The attorney’s recommendations are *not* evidence.” What result? Jurors presented with the low range returned a median award of \$15 million. Those presented with the high range came in at \$50 million (Hastie and Dawes, 2001, p. 106). This example illustrates **anchoring**.

We have encountered anchoring before, though we didn’t use the term. When you declined to walk two blocks to save \$25 on the price of a couch, it is because you were anchored on the price of the couch instead of the \$25. When I said you should concentrate on your aspiration point and not on your reservation point or BATNA, I was trying to dissuade you from anchoring on the lower number. If you fall for the good cop/bad cop gimmick, you are anchoring on the bad cop. Anchors are everywhere. They’re one of the design features of our judgment system.

From this, for the sufficiently devious mind, it is only a small step to the realization that I don’t have to wait to see what your mind happens to seize upon as an anchor. I can plant something. Observe:

Question 1: What is your estimate of the weight of the building you are now in? A rough estimate will do. Say, to the nearest 100 metric tons.

Question 2: What is your estimate of the weight of the building you are now in? A rough estimate will do. Say, to the nearest 10,000 metric tons.

Of course I don’t know what the answer is, and I don’t know what your guesses were, but I am confident that the answer if I asked you only Question 1 would be significantly less than your answer if I asked you only question 2.

Why? Because you don’t have a mental program for generating building weights. When you were asked to produce one you looked around the mental landscape and picked the nearest likely candidate, the anchor, and you adjusted from there. When I provided an anchor of 100 metric tons, you adjusted from there. When I provided an anchor of 10,000 metric tons, you adjusted from there.

It gets scarier. The classic anchoring experiment goes like this. Subjects were asked to spin a big wheel with numbers on it. Unknown to the subjects, the apparently random wheel was rigged to land on either 10 or 65. Then, as part of a completely unrelated task, the subjects were asked a completely unrelated question: “What percentage of the countries in the UN are in Africa?”

On average, the people whose wheel spin landed on the low number estimated that 25 percent of UN countries are in Africa. The people who landed on the higher number estimated 45 percent (Kida, p. 180).

Two distinct facts about anchoring are important. The first is that in estimating we tend to start from a reference point, an anchor, and then adjust. The second is that we fail to adjust sufficiently. Juries, for example, hand down harsher verdicts if they consider more serious charges first than if they consider less serious charges first (Kida, p. 182).

Further, we tend to adjust insufficiently from our anchors even when the anchor is conceptually unrelated to the question under consideration.

So, getting back to our negotiation, we should be acutely aware that the first number that gets put out on the table can serve as an anchor for the whole deal. It can establish the negotiating neighborhood.

§2.01(e) Endowment Effect

Human beings tend to overvalue anything perceived as “mine.” It is in the nature of a man’s mind. A thing which you enjoyed and used as your own for a long time, whether property or opinion, takes root in your being and cannot be torn away without your resenting the act and trying to defend yourself, however you came by it.

- O. W. Holmes (quoted in Thaler, 1992, p. 76)

This is called the **endowment effect**. An easy way to see how it works is to pick something that belongs to you and ask yourself two questions about it. Pick your house, your car, or your laptop — any non-trivial object will do. Ask yourself, What is the least amount of money I would accept to sell this thing? Then ask yourself, If I didn’t already own it, what is the greatest amount of money I would pay to buy it?

Classical economics says the answer to the two questions will be the same. The value of an object to you is the price at which you would be equally willing to buy it or to sell it — the **indifference point**. It’s related to the way we assure that the division of one cookie between two children is fair. If one child cuts the cookie and the other chooses first, the cutter will try to cut at the point where she is indifferent to which piece she winds up with. The indifference point is, by definition, the fair point of division. But it turns out that isn’t the way people think about objects that belong to them. The way we actually think, the indifference point moves.

If you are like most people, there is a difference between the amount you would sell your laptop for and the amount you would pay to buy it. The smallest

amount you would accept to sell it is greater than the largest amount you would pay to buy it. Because of the endowment effect you would not be able to make a deal with yourself!

This is not rational. A rational economic actor places a value on an object. He does not first have to ask, Is it mine?

I had a chance to observe this effect in my own life. I opened the mail one day and found a check for \$3,000 from my friend Lawyer B. I thought it was a mistake and called Lawyer B to ask about it. He said it was a referral fee. It seems many months earlier my wife told me about someone she knew who had been badly hurt in a biking accident. This person was looking for a lawyer to sue the bike manufacturer. I suggested my friend Lawyer A. Lawyer A, in turn, suggested our mutual friend Lawyer B. Lawyer B filed suit and got a substantial settlement with a one-third contingent fee. He sent Lawyer A and me each half of one third of his fee. (This is kosher in Michigan. We are a peer referral state.) I thanked Lawyer B enthusiastically and hung up the phone. But about 10 seconds later I wasn't so delighted. How come I had to share my money with Lawyer A? He didn't do anything.

When my wife got home I told her all about it, including how interesting it was that the endowment effect attached so quickly. Money I didn't know about and wasn't expecting one minute became *my* money the next minute, and I resented having to share it.

"Share it?" she said. "It doesn't have anything to do with you." And with that she picked up the check, put it in her pocket, and I never saw it again.

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Here's an easy endowment-effect thought experiment. Consider the contents of the top drawer of your desk. If your desk is like mine, it contains several unidentified keys, scraps of paper with names and phone numbers from unknown people, business cards from forgotten meetings, a number of pieces of plastic that must have broken off of something or other, some pens that don't work, some pen parts, a cheapo key ring, assorted nuts and bolts, a piece of ancient candy, and so on. A buncha crap, to use the technical term.

Suppose there was a knock at your door and someone stood there with a box containing all that stuff and he offered to sell it to you. "Hi there, wanna buy a box of crap?" You'd probably call a cop.

But suppose your spouse decided to tidy up the place and cleaned out your drawer and threw your crap away. What result?

This little thought experiment shows the power of the endowment effect. People value things that belong to them. It doesn't matter what it is or how long they have had it. Things that are theirs are valuable.

We can do some speculative evolutionary psychology to provide an explanation for why this effect exists. In the ancestral environment it was likely an adaptive strategy to care deeply about your stuff and to resist forcefully anyone who wanted to take it from you. Given a population that cared deeply about its stuff and another population that was more blasé, the blasé folks likely did not survive long enough to reproduce and become our ancestors.

That's fine. But our evolutionary ancestors are not the ones negotiating the settlements of our lawsuits. The effective negotiator (let's call him or her "EN" for short) would be aware of that and adjust for it. The endowment effect causes people to put undue value on things that belong to them. It accounts for some of the value your opponent puts on his case, and it accounts for some of the value you put on yours.

As we shall see, the principle applies not just to physical stuff. As Mr. Justice Holmes said in the quotation above, it also applies to opinions.

2.01(i) Availability Heuristic

Ask yourself this question: What percentage of the housework do I do? Write that number down so there can be no cheating. Now go ask the people you live with to answer the same question for themselves and to write their numbers down. Add the numbers up. More than 100 percent, isn't it?

Part of this can be explained by the way the data comes in. Every time I take out the garbage or empty the kitty litter, I have to stay right there for the entire grueling operation. When my wife does it, it seems (to me) to happen by itself. The box was full and now it's empty. Easy. The floor was muddy and now it's not. Like magic. My contributions take up more mental space than hers. I look at the area covered by memories of me working and compare it to the area covered by memories of her working, and I come up with an estimate of our relative contributions. Oddly, it is an estimate with which she disagrees. This process has a fancy name, naturally. The tendency to mistake the most available information for the most relevant information is called the **availability heuristic**.

The availability heuristic is what causes us to fear the wrong risks. Here's a test. From each of these three pairs, choose the one that is the more common cause of death in the United States:

poisoning or tuberculosis
homicide or suicide
all accidents or stroke

Most people choose the first term in each pair. But it is the second cause that is more common.

Remember the central idea of evolutionary psychology: We are the inheritors of minds formed when humans lived in hunter-gatherer bands. We are adapted to living in groups of 100 to 150 people. Once a group gets much larger than that, it becomes difficult for everyone to know everyone else. Since we are likely to work best, work hardest, make the most sacrifices, and take the most risks on behalf of people we know, it makes sense that groups of 100 or so are among the most efficient organizations. Military organizations, for example, have been organized into groups of 100 soldiers since the days of the Roman centurions.

In a group of 100 people, there aren't very many freak accidents. In the ancestral environment, if you hear somebody got eaten by a shark, then: (a) it will be somebody you know, and (b) it makes good sense for you to be afraid of sharks. Today if any one of six billion people gets eaten by a shark, you are likely to hear about it. Because the brain we have is the one we inherited, the brain processes that information the way our hunter-gatherer ancestors would have processed it. We are afraid of being eaten by sharks.

Let's do the math. Suppose on any given day there is a 1 in 100-million chance that someone will accidentally poke his eye out with a stick. In a group of 100 people, that translates to one occurrence in a million days or roughly 3,000 years. In a world with six billion people, a 1 in 100-million occurrence is likely to happen 60 times a day. And with television and camcorders and YouTube, it's likely that someone will post a picture of it. The ancestral brain doesn't know about YouTube. When it sees something, it reacts as though the thing it's seeing were happening in real time and real space. It thinks it makes sense for you to be afraid. As recently summed up by David Myers: "We fear what our ancestral history has prepared us to fear. ... We fear what we cannot control. ... We fear what is immediate. ... We fear threats readily available in memory." (Myers, 2007).

§3.03(r) Biased Punctuation Of Conflict

Another way we persuade ourselves we are right is called **biased punctuation of conflict**. The Israelis and the Palestinians are a good example. When the I's blow up something belonging to the P's, they always justify it as retaliation for some earlier occasion when the P's blew up something that belonged to the I's. The P's don't see it that way. They see the previous explosion as retaliation for something the I's did before that. Each side punctuates the ongoing narrative so that each of its own strikes is justified and each of the other side's strikes is a fresh provocation. The mutual slaughter continues because each side punctuates the narrative in a way that makes their next move mandatory.

This results from a feature of human experience we discussed in §2.01(i), the fact that my experience is available to me and your experience is not. One consequence of this was shown in an experiment at the University of Texas. Subjects were asked to play the role of world leaders contemplating a nuclear strike. They made statements to one another followed by replies, followed by responses to those replies and so on. Some time later the subjects were shown some of the statements and asked what had been said just before or just after each statement was made. The finding was that the subjects could remember what they themselves did in response to statements by their opponents, but not what their opponents did in response to theirs. As the Harvard psychologist Daniel Gilbert put it in a July 24, 2007 *New York Times* op-ed, “[V]olunteers remembered the causes of their own statements and the consequences of their partner’s.”

Another result of this feature of our mental makeup is, again quoting Gilbert, “[T]he pain we receive seems more painful than the pain we produce.” This was shown in an experiment at University College London. Subjects were assigned to pairs and connected to a device that measured precisely how much pressure each participant exerted onto the other’s fingers. The subjects were told they were to apply exactly as much pressure to their partner’s fingers as the partner had applied to theirs. The machine measured what really happened. And what really happened was that the experiment quickly degenerated into unpleasantness. According to the carefully calibrated measuring device, subjects trying their best to exert exactly as much pressure as had been exerted on them actually responded with about 40 percent more force than they had experienced.

What happens to me is different than what happens to you. Even when it’s the same.

§3.03(f) Reactive Devaluation

Very often people feel that their negotiation opponent is their enemy. If my opponent is my enemy, what is good for my opponent is bad for me. If my opponent makes a proposal, it must be because he would like me to accept it. But if what is good for him is bad for me, then I shouldn’t accept it. Therefore, if my opponent makes a proposal, I shouldn’t accept it. This line of thought presents a problem and, naturally, it has a name. It is called **reactive devaluation**.

Reactive devaluation is usually explained with reference to another concept called **fixed-pie perception**. This is the idea that the totality of benefits to be distributed among participants in the negotiation is like a pie, and that the pie cannot be enlarged. Every piece my opponent gets is a piece I don’t get. The game theorists’ term for this scenario is **zero-sum**. Every time I win (+1 for me), you lose

(-1 for you), and vice versa. Since every +1 is paired with a -1, the game total is always 0.

This win-lose scenario was certainly prevalent in the scarcity environment of our hunter-gatherer ancestors. If you eat the rabbit, I don't. But our world is more complicated. The pie is sometimes fixed, but not as often as we tend to think. Even in the case of a one-time sales transaction — with no continuing relationship between the parties, no reputational concerns at stake for either of the negotiators, and no linkage to future negotiations — there may still be an opportunity to trade off issues of more value to one party in exchange for issues of more value to the other. We just saw an example of this in the case of the buyer with the cash-flow problem. He was willing to pay a premium price in exchange for favorable payment terms. If the seller does not have a similar cash problem, the trade-off can benefit both parties. If the seller has an incentive to defer receipt of the payment into the next tax year, the sum total of mutual benefit may increase further.

The fixed pie perception is an illusion. It is vestigial thinking from the ancestral environment. The current fascination with **mutual-gains bargaining** is not some hippie notion about being nice to each other. It is a rational approach to getting more stuff for you and your client.

Suppose there are six apples and six oranges to be divided between us. The solution that immediately presents itself, the prominent solution, is to split them down the middle. You get three apples and three oranges; I get three apples and three oranges. No one can argue with that.

But suppose I like oranges more than I like apples. If you like apples just as well as oranges, I'll trade you one of my apples for one of your oranges and we get a deal that makes me happier without making you sadder. If you like apples more than you like oranges, we can make a deal that makes us both happier.

Fixed-pie perception leads me to believe that your valuations are the same as mine. I assume that if I like oranges better than apples, so do you. I assume further that if I were to tell you that I like oranges better than apples, you would use that knowledge against me. You would squeeze me to get more payment for the oranges. (Sorry.) So I withhold that information. Out of concern that you will use my preferences to take advantage of me, I fail to reveal them. And I wind up with a bunch of apples I don't want.

Worse, I may even misread an offer from you. If I view the negotiation as fixed-pie and I view you as sharing my valuations, how would I view an offer from you to give me more oranges in exchange for more apples? I would view it as a trick. For a fuller discussion of this problem, see *Barriers to Conflict Resolution* (Arrow et al., 1995).

It is time to get away from these fruity examples and talk about something more serious. Let's take nuclear war. Here is Congressman Floyd Spence of South Carolina talking about the Strategic Arms Limitation Talks (SALT):

I have had a philosophy for some time in regard to SALT, and it goes like this: The Russians will not accept a SALT treaty that is not in their interest, and it seems to me that if it is in their interest, it can't be in our best interest. (Quoted in Bazerman & Neale, 1992, p. 19)

This is as clear an example of reactive devaluation as I have ever seen. It is a measure of the power of this illusion that the good Congressman was willing to risk nuclear destruction rather than call the principle into question.

*Your proposition may be good,
but let's have one thing understood —
whatever it is, I'm against it!
And even when you've changed it or condensed it,
I'm against it!*

Marx Brothers, *Horse Feathers*, 1932

Perhaps following Groucho's example, Chairman Mao said in 1939, "We should support whatever the enemy opposes and oppose whatever the enemy supports."

Here's a more current example of reactive devaluation. One of the members of the Michigan Employment Relations Commission told me recently about a collective bargaining negotiation he was once involved in. The employer proposed a four-day week. The union told him in private, "We want it, but we're afraid it might be good for the company."

Reactive devaluation is abroad in the land; there can be no question about it. Especially in negotiations with a high degree of associated emotion — family disputes, for example — there is a strong tendency to view any proposal from the other side as a trick. The logic is simple. My opponent is an SOB. He will propose something only if it benefits him. The pie over which we are negotiating is fixed, so anything that benefits him must harm me. Since any offer he proposes will really be for his own benefit and must therefore harm me (even if I can't see how), I must reject the offer.