REFERENCE POINTS, SOCIAL NORMS, AND FAIRNESS IN CONTRACT RENEGOTIATIONS

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Abstract
How does an ex ante contract affect behavior in an ex post renegotiation game? We address this question in a canonical buyer-seller relationship with renegotiation. Our paper provides causal experimental evidence that an initial contract has a highly significant and economically important impact on renegotiation behavior that goes beyond the effect of contracts on bargaining threat points. We compare situations in which an initial contract is renegotiated to strategically equivalent bargaining situations in which no ex ante contract was written. The ex ante contract causes sellers to ask for markups that are 45% lower than in strategically equivalent bargaining situations without an initial contract. Moreover, buyers are more likely to reject given markups in renegotiations than in negotiations. These effects do not depend on whether the contract was written under competitive or monopolistic conditions. Our results provide strong evidence supporting the hypothesis that contracts serve as reference points that shape and coordinate the expectations of the contracting parties.
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