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Buying a pig in a poke: An experimental study of unconditional veto power

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Abstract

We study an ultimatum experiment in which the responder does not know the offer when accepting or rejecting. Unconditional veto power leads to acceptances, although proposers are significantly greedier than in standard ultimatum games, and this is anticipated by responders. We also elicit responders' willingness to pay for (un)conditional veto power. The bids reveal a large endowment effect.

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1. Introduction

We examine behavior in a variation of the ultimatum game (UG) that we call "Yes or No-game" (Y/N). Unlike in UG, the responder in Y/N does not know the proposal when

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deciding between "yes" (acceptance) and "no" (rejection). In this sense, accepting means to "buy a pig in a poke".[1]

Previous research has shown that many responders in standard UG are unwilling to accept "unfair" offers (for surveys see Roth, 1995 or Camerer, 2003), and that proposers offer substantial amounts with the modal offer typically being half of the pie. Earlier experiments investigating UG with one-sided incomplete information have observed that proposers make (and responders accept) significantly lower offers when responders do not know the size of the pie and when the lack of information is common knowledge (see, e.g., Croson, 1996; Kagel, Kim, & Moser, 1996; Mitzkewitz & Nagel, 1993; Rapoport & Sundali, 1996; Rapoport, Sundali, & Seale, 1996). While in these games the responder knows the proposer's offer but not the pie size, in our Y/N-game the responder knows the pie size but not the offer at the time of accepting or rejecting. In game theoretic terms, one might say that in the former literature information was incomplete, whereas in our Y/N-game it is imperfect. Yet, assuming that responders are selfish payoff maximizers, these differences should not matter, in the sense that in both games responders have a (weakly) dominant strategy to accept all offers, independent of the (non-negative) offer amount or pie size. However, in a world with social preferences, such as postulated by Bolton (1991), Bolton and Ockenfels (2000), or Fehr and Schmidt (1999), lack of information can create moral hazard problems. Proposers can try to exploit the fact that responders cannot observe the "quality" or "fairness" of the offer. One consequence would be that responders have an incentive to transform the game with unconditional veto power (Y/N) into a game with conditional veto power (UG). These hypotheses are tested in two series of experiments.

In the *first experiment series* (taken from Güth, Levati, Ockenfels, & Weiland, 2005), we compare behavior in the UG, Y/N and the dictator game (DG), where responders have no veto power at all. We find that offers in Y/N are significantly lower than in UG and similar to those in DG. While the greediness of Y/N proposers is anticipated by the responders, we do not observe any rejection.

In the *second experiment series* (taken from Gehrig, Güth, Levinsky, & Uske, 2006), we elicit responders' willingness to pay for transforming both the Y/N-game into an UG and the UG into a Y/N-game. As elicitation procedure we use the incentive compatible random price mechanism by Becker, DeGroot, and Marschak (1963). The main result is that responders anticipate the (dis)advantage of UG (Y/N) as they are willing to pay a significantly positive (negative) amount for changing the game. However, they seem to underestimate the benefits of the UG.

2. Experimental procedures

All sessions of the *first experiment series* were computerized (via Fischbacher, 2007, z-Tree) and performed at the experimental laboratory of the Max Planck Institute in Jena.

[1] As an economic example for the Y/N-game, consider a producer and a customer who can engage in mutually profitable trade of one unit at a given price. The product can be delivered in variable quality, which the customer cannot verify before deciding whether to buy it or not. By varying the quality level, the surplus from bilateral exchange can be distributed between the trading parties. This situation somewhat resembles the so-called lemon market for which Akerlof (1970) predicted no trade. However, our situation simplifies the situation in the sense that lemons (minimum quality) yield the same total surplus as products of better quality. Moreover, contrary to Akerlof's study, quality can vary continuously, and the market is a bilateral monopoly.