Introduction

Consider a simple labor market/ salary negotiation.

Company
Total value created through employment: v.
Company can hire someone else and receive b.

Agent (you)
Reservation wage: a

Best Alternative to a Negotiated Agreement
- Agent receives reservation wage: a
- The company hires the next best employee and receives b.

Nash Cooperative Solution

- Agent receives $w_1 = a + (1 - p)(v - a - b)$
- Company receives $b + p(v - a - b)$

What does p stand for?
- The relative bargaining strength of the company or
- How likable you are or
- A measure of the agent's preference for this job compared to the next best alternative. Example: p =0, p= ½, and p=1
- Evidence shows that a 50-50 split is common (p=½).

Do empirical examples

Detailed analysis of the variables

Company

Company's next best alternative: $b = (v - w_2) * \beta_c^t$

Agent (you)

Discounted pay for the next best alternative: $a = r * \beta_a^t$

w_2 is the pay of a more experienced candidate

β is a discount rate, this represents a loss of utility from waiting to get the next job.

How can we get more money?

Assume that we always negotiate for half of the value, p= 0.5

- $w_1 = a + (0.5)(v - a - b)$

- Company's next best alternative: $b = (v - w_2) * \beta_c^t$

- Discounted pay for the next best alternative: $a = r * \beta_a^t$

How can we maximize our payoff?
1. Maximize our next best alternative: a.
2. Minimize the company's alternative option value: b.

How can we minimize b?
- Specializing in a valuable task that companies need to pay for will increase the expected salary of the next person: Increase w_2.

- Specializing in a task that is difficult to find someone else to complete, which causes t to grow larger.

How can we maximize a?
- Increase the value of your next alternative r.
- Be more patient; this will increase β.
- Have a high-demand skill: minimize the time to find the next position: t.