Face-to-face bargaining fails because of unpersuasive arguments.

The arbitrator’s ability of recognizing arguments is low.

Final-offer arbitration creates lower deadweight loss than conventional arbitration.

The arbitrator’s ability of recognizing arguments is high.

Conventional arbitration creates lower deadweight loss than final-offer arbitration.

Conventional arbitration dominates final-offer arbitration in terms of outcome accuracy.

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Table 1. The term *unpersuasive arguments* refers to situations in which arguments that are persuasive to one party may not be persuasive to the other party. *Deadweight loss* stands for the chance of rejecting a settlement payment in face-to-face negotiations and filing a request for arbitration; and *outcome accuracy* stands for the departure of the arbitration outcome from the existing contractual arrangement.
B learns that the state is a, but makes up an argument that the state is b.

A learns that the state is a; Arbitrator learns that the state is a.

Arbitrator finds both states equally likely; A cannot distinguish the two information nodes.

Figure 1(a)
Figure 1(b)
Settlement Payment, $s \geq 0$

Period 1:

B

Accept

Reject

Final Payoffs of A and B, respectively:

$-s, +s$

Arbitrator

Payment $\pi$ from A to B

Final Payoffs:

$-c - \pi, -c + \pi$

Figure 2
Small $\eta$

Figure 3(a): The equilibrium $\beta$ under conventional arbitration equals $\frac{1}{2}$, as the marginal cost $MC_C$ exceeds the marginal benefit $MB$. The marginal cost $MC_{F-O}$ is lower than $MC_C$, so the equilibrium $\beta$ under final-offer arbitration may be higher than $\frac{1}{2}$. 
Figure 3(b): The equilibrium $\beta$ under conventional arbitration equals 1, as the marginal cost $MC_C$ is very close to 0, and falls below the marginal benefit $MB$. The marginal cost $MC_{F-O}$ is higher than $MC_C$ (except a neighborhood of $1/2$), so the equilibrium $\beta$ under final-offer arbitration may be lower than 1.
Figure 4: The determination of the offers $\pi_A$ and $\pi_B$ under final-offer arbitration in the pooling equilibrium in which agent A responds to her opponent's offer, assuming that $F^\beta$ is the cdf of the arbitrator's peak points; and agent B responds to his opponent's offer assuming that $F^0$ is the cdf of the arbitrator's peak points.