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Trader Matching and the Selection of Market Institutions

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Abstract

We analyze a stochastic dynamic learning model with boundedly rational traders who can choose among trading institutions with different matching characteristics. The framework allows for institutions featuring multiple prices (per good), thus violating the "law of one price." We find that centralized institutions are stochastically stable for a broad class of dynamics and behavioral rules, independently of which other institutions are available. However, some decentralized institutions featuring multiple prices can also survive in the long run, depending on specific characteristics of the underlying learning dynamics such as fast transitions or optimistic behavior.

Keywords: Market Institution, Law of One Price, Matching, Stochastic Stability
JEL: C72, C73, D4, D83

1. Introduction

Market institutions come in many flavors. In many markets, institutions with different characteristics exist, even for the same good. Those can be formal, as e.g. specific Business-to-Business (B2B) or Business-to-Consumer platforms, middlemen agencies, or local markets for perishable products (fish and produce), or informal, as e.g. exchange arrangements, black markets, or the set of particular conventions surrounding real-estate and rental markets in certain countries (group-tenant vs. individual visits). The characteristics of such market institutions in turn influence market outcomes in terms of efficiency, surplus distribution and convergence

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