PRSE
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ABSTRACT:

Brokerage

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Dominant intermediaries are a defining feature of the modern economy. This paper studies the mechanisms that give rise to trading networks with a dominant intermediary. Trades between actors require a direct link or a path that involves intermediaries. Links are costly. Efficiency therefore pushes towards connected networks with few links: this set includes the hub-spoke network, the cycle network and their variants. The hub-spoke network exhibits extreme inequality, while the cycle network yields equal payoffs for all traders. We conduct a large-scale experiment on link formation among traders; the game takes place in continuous time and allows for asynchronous choices. The main finding is that the pricing protocol - the rule dividing the surplus between traders and intermediaries - determines which of these two networks arises.