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Price Formation by Bargaining and Posted Prices

Walrasian complete market paradigm where in equilibrium prices equate demand and supply is unsatisfactory in many respects. A popular alternative is to consider markets where agents meet randomly. Questions about price formation become then relevant, and it is not immediate how to formalise the trading procedure. I consider two popular methods, namely bargaining or negotiations and posted prices. However, I take the stand that sellers are not capable of committing to a particular trading rule in a competitive environment. In the model this means that in the bargaining market prices are negotiated only if exactly one buyers meets a seller; if there are multiple buyers an auction ensues. The posted price markets are modelled in such a way that before going to the sellers buyers observe prices. Based on this information they choose a strategy which determines to which seller they go. If a seller meets only one buyer the buyer gets the good at the announced price. Otherwise there is an auction again.

The two trading mechanisms distribute the available surplus differently, and this determines their viability. To study their relative performance I employ evolutionary dynamics in which agents drift to the market where their type performs better. It turns out that posted price markets work in this dynamics better, and they are the only evolutionary stable equilibrium, i.e. in the end all the agents go to the posted price markets.