

Summary

Our purpose is to study bilateral trade with asymmetric information. We are interested in the case in which the seller has private information about the good's quality, which affects both his own reservation value, and the buyer's willingness-to-pay. As is well known, private information might lead to inefficiencies: trade might fail to take place even though it is common knowledge that there are gains from trade. This problem, first pointed out by Akerlof (1970), cannot be avoided, whichever institution, or mechanism, is employed. But depending on the mechanism, the problem might be more or less severe. In particular, typically, commitment by the parties to a specific mechanism alleviates inefficiencies. However, in bargaining, a widespread practice, commitment is minimal: the seller can choose offers freely, and the buyer can condition his acceptance on these offers. Under which circumstances is this lack of commitment compounding the inefficiency? If so, whose lack of commitment is to blame? What type of commitment is then called for?

Intellectual merit: we hope to contribute to the theoretical literature in three dimensions:

- Methodologically: to address the questions above, we must identify optimal trading allocations in mechanisms that neither assume full commitment, as is almost always done in mechanism design, nor focus on specific game forms. What happens if we relax the buyer's: instead of assuming that he must break even in the mechanism on average, what if he must do so given the actual terms of trade? This seems to be both natural and realistic. Yet solving this requires new methods.
- Conceptually: one of our goals is to understand the sources of additional inefficiencies, if any, that bargaining (or other protocols with minimal commitment) generate. Is it the seller's ability to formulate offers, unlike in fixed-price mechanisms? Or the buyer's ability to have the offer in hand before taking a decision?
- Bargaining: Despite the large literature on bargaining, most scholars have shied away from an analysis in which the informed party makes offers. This is largely for technical reasons, as it is difficult to circumscribe all the beliefs that the buyer could entertain after out-of-equilibrium offers. We believe that, as in repeated games, equilibrium multiplicity does not prevent a characterization of the set of equilibrium payoffs, once the relevant incentive constraints are properly understood.

Broader impact: Our analysis should shed light on the role, and relevance of institutions. When is it in society's best interest to restrict market participants' ability to negotiate freely? Which types of price-setting rules are desirable? Should the price be fixed, and if not, which party should choose it? Whose party's freedom should be curtailed in the mechanism? If middlemen are necessary, what is their role?