Who Wants To Be A Middleman?*

Ed Nosal
FRB Chicago

Yuet-Yee Wong
Binghamton University

Randall Wright
University of Wisconsin-Madison,
FRB Chicago, FRB Minneapolis and NBER

May 11, 2016

We study agents' decisions to be producers or middlemen in Rubinstein and Wolinsky's search model of intermediation, extended to allow general bargaining, cost and utility. This requires a different approach, but the analysis remains tractable, delivering clean and sometimes surprising results. We characterize equilibrium, show intermediation can be essential, and prove equilibrium is efficient iff bargaining satisfies versions of Hosios' conditions generalized to three-sided markets. We also go beyond the usual linear (transferable) utility specification to capture payment frictions, and

The various roles of middlemen, or intermediaries, have been studied by a number of authors (see fn. 3 below). However, given the importance of middlemen in real-world economic activity, from wholesale trade in producer or consumer goods, to financial intermediation, there would seem to be room for additional work. This project revisits the classic search-based framework introduced by Rubinstein and Wolinsky (1987), hereafter RW, extends it on a number of dimensions, and uses it to analyze a variety pf issues, including the occupationalhoice of agents acting as producers or intermediaries.

of types, say $\mathbf{n} = \{\ {}_i\}$, consistent with $\boldsymbol{\alpha}$, random matching, and the identities implied by bilateral meetings, ${}_i\ {}_{ij} = {}_j\ {}_{ji}$. Hence, those papers conveniently take $\boldsymbol{\alpha}$ as fixed when characterizing equilibrium – but that won't work when agents get to choose their types, since anything that affects $\mathbf{n}$ can affect $\boldsymbol{\alpha}$. Therefore we determine endogenously ${}_{ij} = {}_i\ {}_j$, where ${}_i$ is a baseline arrival rate for type . However, then the relevant identities imply ${}_i =$ is the same for all , and in particular ${}_{pc} = {}_{mc} = {}_c$, so we must abandon the original RW idea that middlemen have a role iff ${}_{mc}\ \ {}_{pc}$. Fortunately other factors here can take over for $\boldsymbol{\alpha}$, including costs and bargaining powers.

Despite these complications, the framework is tractable, delivering clean and sometimes surprising predictions – e.g., increasing the cost of intermediation can lead to more intermediaries. We establish existence and uniqueness of equilibrium, and show how intermediation can be essential – e.g., the market may shut down if middlemen are prohibited. In general, equilibrium can have too few or too many middlemen, and is efficient iff bargaining powers are just right.[2] We also go beyond the usual linear (transferable) utility specification by allowing strict concavity, which is relevant because, as discussed below, nonlinearity in payments interacts with intermediation. And we go beyond the usual steady state analysis by establishing saddle path stability of dynamic equilibrium. Finally, by reinterpreting some parameters, we introduce new applications, including financial intermediation, which has some novel implications.

Based on these results, we suggest the model is an advance over previous specifications for economists interested in intermediation, or in search theory more generally. The rest of the paper involves making the assumptions precise and verifying the results. Section 2 describes a benchmark environment. Sections

[2]This is related to standard results going back to Mortensen (1982) and Hosios (1990), but is also slightly different, because RW-style environments concern three-sided markets, with producers, consumers and middlemen.

3 and 4 study equilibrium and efficiency in the linear economy. Sections 5 and 6 consider nonlinear utility and dynamics. Section 7 introduces new applications. Section 8 concludes. The Appendix contains technical results.[3]

There is a continuum of infinitely-lived agents. Some are called consumers, and labeled , with measure $_c$. The rest choose to be producers, middlemen or nonparticipants, labeled , or , with measure $_p$, $_m$ or $_n$, where $_c +$ $_p +$ $_m +$ $_n = 1$. Let $\mathbf{n} = (_c \quad _p \quad _m \quad _n)$. Type agents produce whenever they can and type agents trade whenever they can (this is how we define and ; those who do not want to act this way are type). Type agents trade and consume whenever they can. Agents meet bilaterally in continuous time according to a uniform random-matching process, with $_j$ the Poisson rate at which anyone meets type . Without loss of generality, normalize $= 1$.

There are two goods, and . Good is indivisible, and is valued for consumption only by type . They get utility from consuming a unit of . This good is storable, but only 1 unit at a time, at cost $_p$ for type and cost $_m$ for type . It is produced by type at cost , but for most purposes we can normalize $= 0$ without loss of generality – as in Pissarides (2000), what matters is the total expected discounted cost, including entry, production and search, so we do not need them all. While cannot produce he can acquire it from

[3]For motivation, it is hard to improve on RW: "Despite the important role played by intermediation in most markets, it is largely ignored by the standard theoretical literature. This is because a study of intermediation requires a basic model that describes explicitly the trade frictions that give rise to the function of intermediation. But this is missing from the standard market models, where the actual process of trading is left unmodeled." The situation has improved since then, and in particular work on intermediation with occupation choice includes Bigalser (1993), Wright (1995), Li (1998), Camera (2001), Johri and Leach (2002), Shevchenko (2004), Smith (2004), Du

to retrade it to . Good is divisible but nonstorable. All agents can produce at constant marginal cost in terms of utility, normalized to 1, and can consume it for utility ( ), where for now ( ) = , but later we consider $''( )$ 0. As in the original RW model, ( ) = means that transferable utility is used to pay for , so there are no frictions in the payment process.

Type agents always have 1 unit of and type agents always have 0, since the former produce and the latter consume right after trade, while type agents can have 0 or 1 unit of in inventory. Given that accepts from , let denote the fraction of with . Then increases at rate $_p \; _m(1-\;)$ (the measure of meeting without) and decreases at rate $_c \; _m$ (the measure of meeting with). The steady state is therefore given by

$$= \frac{{}_p}{{}_p + {}_c} \tag{1}$$

We focus for now on steady states, and consider dynamics in Section 6.

Bargaining determines the terms of trade. Agents and split the total surplus with $_{ij}$ denoting the share, or bargaining power, of and $_{ji} = 1 - \; _{ij}$. As in previous analyses of RW, with transferable utility, this follows from various solution concepts, including Nash, Kalai and various strategic bargaining games (see Wright and Wong 2014 for more discussion). The surplus of type meeting type is $-\; _{cp} = \; _{cp}$, because $_{cp} = \; _{pc}$, given that for both and the continuation values and outside options cancel.[4] Similar expressions hold for the other surpluses, and allow us to eliminate $\mathbf{y} = (\; _{cp} \; _{mp} \; _{cm})$ from the payoffs.

Let $_p$ be 's payoff or value function. Let $_0$ or $_1$ be 's value function when he has 0 or 1 unit of . Let $_c$ and $_n = 0$ be 's and 's value functions, and $\mathbf{V} = (\; _p \; _0 \; _1 \; _c \; _n)$. Eliminating the 's from the 's, we get the dynamic

[4]This is because our agents all stay in the market forever. In the original RW setup, P and C exit after trading, to be replaced by clones, while M stays forever. Nosal et al. (2015) nest these formulations by having agents stay after trading with a type-specific probability; having them stay with probability 1 reduces the algebra without affecting the results too much.

programming equations

$$_p = \ _c \ _{pc} \ + \ _m(1- \ ) \ _{pm}(\ _1 - \ _0) - \ _p \tag{2}$$

$$_0 = \ _p \ _{mp}(\ _1 - \ _0) \tag{3}$$

$$_1 = \ _c \ _{mc}(\ + \ _0 - \ _1) - \ _m \tag{4}$$

$$_c = \ _p \ _{cp} \ + \ _m \ _{cm}(\ + \ _0 - \ _1) \tag{5}$$

In (2), e.g., the flow value $\ _p$ is the rate at which meets times his share of the surplus, plus the rate at which he meets without times his share of that surplus, minus the flow storage cost $\ _p$. The other equations are similar.

Agents choosing to be type start without , for payoff $\ _0$. Hence, occupational choice comes down to the following considerations:

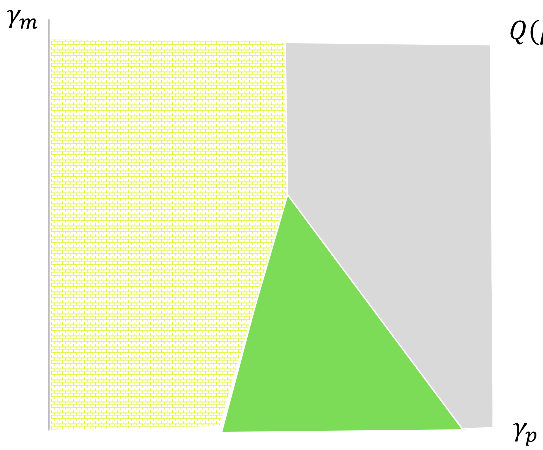
$$_p \quad 0 \Rightarrow \ _p \geq \max\{ \ _0 \ 0\} \text{ and } \ _m \quad 0 \Rightarrow \ _0 \geq \max\{ \ _p \ 0\} \tag{6}$$

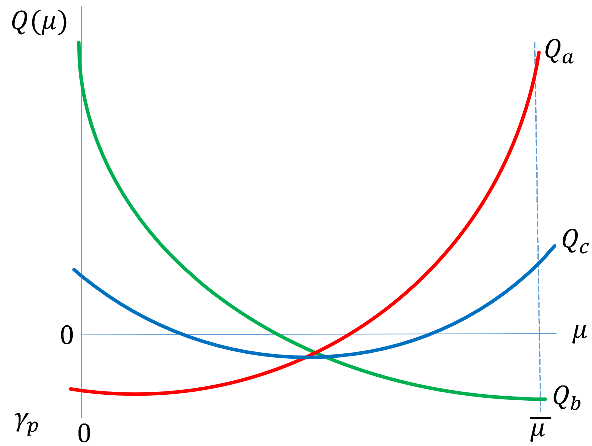
Obviously, $\ _p \ _m$ 0 requires $\ _p = \ _0 \geq 0$. In any case, we have:

fi *A (steady state) equilibrium is a nonnegative list* $\langle \ \mathbf{V} \ \mathbf{n}\rangle$ *such that satisfies (1),* $\mathbf{V}$ *satisfies (2)-(5) and* $\mathbf{n}$ *satisfies (6).*

From this we can compute the terms of trade $\mathbf{y}$, the spread $= \ _{cm} - \ _{mp}$, the stock of middlemen inventories $\ _m$, and other interesting variables.

There are three kinds of outcomes. A *class 0 equilibrium* is one where $\ _p = \ _m = 0$ and $\ _n = 1 - \ _c$, which means the market shuts down. A *class 1 equilibrium* is one where $\ _p = 1 - \ _c$ and $\ _m = \ _n = 0$, with production but no intermediation. A *class 2 equilibrium* is one where $\ _p \ 0$, $\ _m \ 0$ and $\ _n = 0$, with intermediation. The labels are chosen because class 0 implies no active


γ_m
γ_p


$Q(\mu)$
Q_a
Q_c
0
μ
Q_b
0
$\overline{\mu}$

${}_p \leq {}^-{}_p$, and ${}_p \geq {}_0$ iff

$$ {}_m \geq (\ {}_p) \equiv {}^-{}_m - \frac{+\ {}_c\ {}_{mc} + (1-\ {}_c)\ {}_{mp}}{(1-\ {}_c)\ {}_{mp}}({}^-{}_p -\ {}_p) \tag{7} $$

where ${}^-{}_m \equiv\ {}_c\ {}_{mc}$. Since (2)-(5) are linear, there cannot be multiple class 1 equilibria. This proves:

A class 1 equilibrium exists iff ${}_p \leq {}^-{}_p$ *and* ${}_m \geq (\ {}_p)$*, where is defined in (7). When it exists it is unique.*

Now consider class 2 equilibrium, with ${}_p\ \ {}_m\ \ 0$ and ${}_p +\ {}_m = 1 -\ {}_c$, where ${}_p =\ {}_0 \geq 0$. It is convenient to characterize the outcome in terms of , then use steady state conditions to recover $\mathbf{n}$. Clearly we need $\in (0\ {}^-)$, where ${}^- = 1 -\ {}_c$. Then routine algebra reduces ${}_p =\ {}_0$ to $(\ ) = 0$, where $(\ )$ is obtained by replacing ${}_p$ and ${}_m$ with their values in terms of . The result is

$$ (\ ) =\ {}_1\ {}^2 +\ {}_2\ +\ {}_3 \tag{8} $$

a quadratic with coefficients[6]

$$ \begin{aligned} {}_1 &=\ {}_{pm}({}^-{}_m -\ {}_m) \\ {}_2 &= -[2(1-\ {}_c)\ {}_{pm} +\ {}_c]({}^-{}_m -\ {}_m) - (\ +\ {}_c\ {}_{mc} -\ {}_c\ {}_{mp})({}^-{}_p -\ {}_p) \\ {}_3 &= (1-\ {}_c)\ {}_{pm}({}^-{}_m -\ {}_m) + (\ +\ {}_c\ {}_{mc})({}^-{}_p -\ {}_p) \end{aligned} $$

We seek $\in (0\ {}^-)$ such that $(\ ) = 0$ and ${}_0 \geq 0$. Since ${}_0 \geq 0$ iff ${}_m \leq {}^-{}_m$, we restrict attention to ${}_1\ \ 0$, so $(\ )$ is convex. Thus, as shown by the

[6]Much of the analysis in the Appendix deals with quadratic equations, and in one case, in the proof of Lemma 14, a cubic. This is unavoidable, and natural, given random matching and the inventory condition (1). In particular, the rate at which P can trade with M is $\alpha\ {}_m(1-\mu) = n_m n_c/(1-n_m)$, which renders several equilibrium conditions quadratic. Of course it would be easier if $\mathbf{n}$ were fixed, as in previous work, but one of our main objectives is to make it endogenous. Also note that payoffs depend on $\mathbf{n}$ even though our matching technology has constant returns to scale: one meets potential counterparties at a constant rate but the outcome depends on whom one meets, and, for P or C, depends on μ.

curves $_a$, $_b$ and $_c$ in the right panel of Fig. 1, there are three ways ( ) can have a solution in $(0\ \bar{})$: (a) one root with (0) 0 $(\bar{})$; (b) one root with (0) 0 $(\bar{})$; or (c) two roots. The Appendix rules out cases (a) and (c):

A class 2 equilibrium exists iff (0) 0 $(\bar{})$.

To see when the conditions in Lemma 3 hold, note that $(\bar{})$ 0 iff $_m$ $(\ _p)$ where is defined above, while (0) 0 iff $_m$ $(\ _p)$ where

$$(\ _p) \equiv \bar{}_m + \frac{+\ _c\ _{mc}}{}$$

that can be supported as equilibria expands when money is introduced. Surveys by Nosal and Rocheteau (2011) and Lagos et al. (2015) discuss work on the essentiality of money, banking and related institutions. For both money and intermediation, the notion is nontrivial because, e.g., they are clearly *not* essential in the standard environment used in general equilibrium theory. In our environment, in the region where class 2 equilibrium exists with $_p \quad \bar{}_p$, economic activity depends on middlemen being active: if we were to exogenously eliminate type , say by taxing them, the market would shut down. Thus, intermediation may be necessary for production and consumption to be viable. Even if they are viable without intermediation, welfare may be enhanced by having some type agents, but it may also be diminished, as discussed in Section 4.

Additional insights come from changing parameters in a class 2 equilibrium, where solves $(\ ) = 0$. First, notice anything that shifts $(\ )$ up (down) causes to increase (decrease). The Appendix proves the following:

An increase in $_p$ *shifts* $(\ )$ *down; an increase in* $_m$ *shifts* $(\ )$ *down if* $_p \quad \bar{}_p$ *and up if* $_p \quad \bar{}_p$.

Based on these observations, it is immediate that

$$\frac{}{_p} \quad 0, \ \frac{_p}{_p} \quad 0 \text{ and } \frac{_m}{_p} \quad 0$$

This accords well with intuition: when $_p$ is higher, we get fewer producers. However, it is also immediate that

$$_p \quad \bar{}_p \Rightarrow \frac{}{_m} \quad 0, \ \frac{_p}{_m} \quad 0 \text{ and } \frac{_m}{_m} \quad 0$$

$$_p \quad \bar{}_p \Rightarrow \frac{}{_m} \quad 0, \ \frac{_p}{_m} \quad 0 \text{ and } \frac{_m}{_m} \quad 0$$

The case $_p \quad \bar{}_p$ should be surprising: why are there more middlemen when $_m$ is higher? This is answered in Section 4 in the context of efficiency.

In terms of bargaining power, one can check that an increase in $_{pc}$ or $_{pm}$ shifts ( ) up, raising and $_{p}$ while lowering $_{m}$, as again accords with intuition. However, just like $_{m}$, an increase in $_{mc}$ can shift ( ) up or down depending on the sign of $_{p} - \bar{}_{p}$, and therefore

$$_{p} \quad \bar{}_{p} \Rightarrow \frac{}{_{mc}} \quad 0, \frac{_{p}}{_{mc}} \quad 0 \text{ and } \frac{_{m}}{_{mc}} \quad 0$$

$$_{p} \quad \bar{}_{p} \Rightarrow \frac{}{_{mc}} \quad 0, \frac{_{p}}{_{mc}} \quad 0 \text{ and } \frac{_{m}}{_{mc}} \quad 0$$

The reason that an increase in $_{mc}$ works much like a decrease in $_{m}$ is that both make intermediation more profitable, with $_{m}$ operating during the search process and $_{mc}$ operating during the bargaining process.[8]

We now bring back the terms of trade, $\mathbf{y}$. In direct exchange, where gets from , $_{cp} = _{pc}$ is independent of the sunk storage costs, and increasing with 's bargaining power and 's valuation. In wholesale trade, where gets from ,

$$_{mp} = _{pm}(_{1} - _{0}) = \frac{_{pm}(_{c\ mc} - _{m})}{+ _{c\ mc} + _{p\ mp}}$$

The endogenous $_{p}$ is left on the RHS to illustrate a point: there is a direct impact on $_{mp}$ from $_{m}$, but not from $_{p}$; plus there are indirect effects from both through $\mathbf{n}$. Similarly, in retail trade, where gets from ,

$$_{cm} = _{mc}(+ _{0} - _{1}) = _{mc} - \frac{_{mc}(_{c\ mc} - _{m})}{+ _{c\ mc} + _{p\ mp}}$$

One can check $_{mp} \quad _{p} \quad 0$, $_{cm} \quad _{p} \quad 0$ and $_{p} \quad 0$, where $= _{cm} - _{mp}$ is the spread. Less straightforwardly, $_{p} \quad \bar{}_{p}$ implies $_{mp} \quad _{m} \quad 0$,

[8] For completeness we mention how the other parameters affect $\mathbf{n}$. The effect of r, like γ_m, depends on γ : $\gamma < \bar{\gamma}$ implies $\partial\mu/\partial r > 0$, $\partial n /\partial r > 0$ and $\partial n_m/\partial r < 0$, while $\gamma > \bar{\gamma}$ implies $\partial\mu/\partial r < 0$, $\partial n /\partial r < 0$ and $\partial n_m/\partial r > 0$. A demand increase on the intensive margin, captured by higher u, is less clear: Since what matters is γ /u and γ_m/u, raising u has the same impact as lowering both γ and γ_m. If $\gamma > \bar{\gamma}$ then higher u raises n and lowers n_m; if $\gamma < \bar{\gamma}$ then the effect can go either way. Similarly ambiguous is an increase in demand on the extensive margin, captured by higher n_c.

$_{cm}$ $_{m}$ 0 and $_{m}$ 0, but $_{p}$ $^{-}{}_{p}$ implies the effects are ambiguous. Some changes in bargaining powers are ambiguous, too, while others are not. In any case, the results would be different if **n** were exogenous, as then the indirect effects vanish. This is one reason to study occupational choice. Another is to examine the welfare implications.

ffi

We now solve a planner's problem, where for simplicity the focus is on ≈ 0. The problem is to choose $(\;^{o} \; {}^{o}_{p} \; {}^{o}_{m})$ to maximize:[9]

$$= \;_{p}(\;_{c} - \;_{p}) + \;_{m}(\;_{c} - \;_{m})$$

Consider first $_{m}$ $_{c}$, which means intermediation is not viable, because it contributes negatively to . Given $_{m}$ $_{c}$ we have: $_{p}$ $_{c}$ implies ${}^{o}_{p} = 0$ and the market shuts down; and $_{p}$ $_{c}$ implies ${}^{o}_{p} = 1 - \;_{c}$ and the market opens with direct trade only.

Next consider $_{m}$ $_{c}$, which means intermediation is viable but may or may not be optimal. Eliminating $_{p}$ and $_{m}$ we reduce the planner's problem to

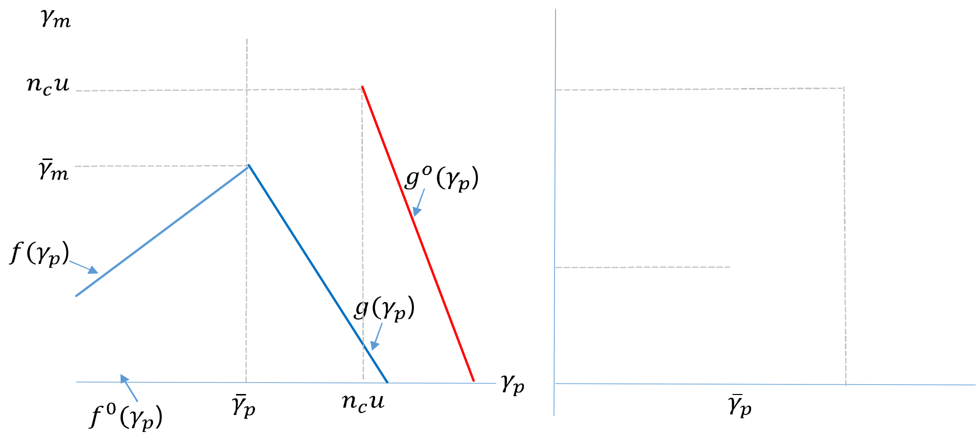
$$\max_{\mu\in[0,\bar{\mu}]} \left\{ \;_{c} - \;_{c}\frac{\quad}{1-\quad} \;_{p} - \frac{1- \;_{c} -}{1-\quad} \;_{m} \right\}$$

After simplification, the derivative of the objective function is proportional to

$$^{o}(\;) = (1- \;)^{2}(\;_{c} - \;_{m}) + \;_{c}(\;_{m} - \;_{p}) \tag{10}$$

which is a quadratic and decreasing in over the relevant range.

[9] The first (second) term is the net social surplus from direct (indirect) trade. Similar to the related analysis in Nosal et al. (2015), one can solve the dynamic problem with $r > 0$ and, as usual, the outcome is the same as maximizing rW when $r \to 0$. Also, as is standard $V_j \to \infty$ when $r \to 0$, but rV_j and rW are well defined. Of course, small r can be interpreted as saying search frictions are not overly severe.


γ_m
$n_c u$
$\bar{\gamma}_m$
$f(\gamma_p)$
$g^o(\gamma_p)$
$g(\gamma_p)$
γ_p
$f^0(\gamma_p)$
$\bar{\gamma}_p$
$n_c u$
$\bar{\gamma}_p$

from equilibrium, where ${}_m \quad {}_p$ is neither necessary nor sufficient for ${}_m \quad 0$. It is also different from models with fixed **n**. In such models, if ${}_m$ is close to ${}_p$ it is always a good idea for to trade to , so can produce another unit, and put more on the market. The economics is different here, because can turn into and produce on his own. This is summarized as follows:

The efficient outcome exists and is generically unique, as shown in Fig. 2.

Before further comparing the efficient and equilibrium outcomes, consider the effects of parameters on the planner's solution when ${}^{o} \in (0 \quad {}^{-})$. First,

$$\frac{{}^{o}}{{}_{p}} \quad 0, \; \frac{{}^{o}_{p}}{{}_{p}} \quad 0 \text{ and } \frac{{}^{o}_{m}}{{}_{p}} \quad 0$$

which is similar to the equilibrium result, and intuitively clear. Next,

$$\begin{aligned} {}_p \quad {}_c &\Rightarrow \frac{{}^{o}}{{}_{m}} \quad 0, \; \frac{{}^{o}_{p}}{{}_{m}} \quad 0 \text{ and } \frac{{}^{o}_{m}}{{}_{m}} \quad 0 \\ {}_p \quad {}_c &\Rightarrow \frac{{}^{o}}{{}_{m}} \quad 0, \; \frac{{}^{o}_{p}}{{}_{m}} \quad 0 \text{ and } \frac{{}^{o}_{m}}{{}_{m}} \quad 0 \end{aligned}$$

which is similar to the equilibrium result, and again surprising. To explain why higher ${}_m$ can lead to more middlemen, the following is useful:

For all parameters, $({}^{o}_{m} \quad {}^{o}) \quad {}_m \quad 0.$

Here is the economic explanation: If ${}_m$ increases, the natural response is to reduce inventories held by , given by ${}_m$, but there are different ways to do so. One is to reduce ${}_m$, which in steady state means higher ; the other is to reduce , which means higher ${}_m$. When ${}_p \quad {}_c$ it is optimal to use the extensive margin and reduce ${}_m$; when ${}_p \quad {}_c$ it is optimal to use the intensive margin and reduce , which means higher ${}_m$. This explains the planner's choices. The idea is similar for equilibrium, but less transparent, as complications can make that different from the efficient outcome, as we now discuss.

Equilibrium can involve too many type and too few type , or vice versa. In the shaded region in the left panel of Fig. 2, between $({}_p)$ and ${}^o({}_p)$, we have ${}_m \quad 0 = {}^o_m$ and equilibrium has too many middlemen. There is also a region where equilibrium has too few. The situation in the right panel, drawn for different parameters, is similar. Also, even if the equilibrium and efficient outcomes are both class 2, we only get ${}_m = {}^o_m$ if bargaining powers are just right. To see this, define ${}^o_0$, ${}^o_1$ and ${}^o_2$ as the sets of 's where the efficient outcome is class 0, class 1 and class 2, respectively. Then we have:

Equilibrium is efficient iff ${}^o_{pc} = {}^o_{mc} = 1$ *and: (i)* $({}_p \quad {}_m) \in {}^o_0 \Rightarrow {}^o_{pm} = 1$*; (ii)* $({}_p \quad {}_m) \in {}^o_1 \Rightarrow {}^o_{pm} = 0$*; and (iii)* $({}_p \quad {}_m) \in {}^o_2 \Rightarrow$

$$ {}^o_{pm} = \frac{(1 - {}^o)(1 - {}_c - {}^o)}{(1 - {}^o)(1 - {}_c - {}^o) + {}^o\, {}_c[1 - ({}_c - {}_p) \; ({}_c - {}_m)]} \in (0 \;\; 1) $$

Heuristically, ${}^o_{pc} = 1$ and ${}^o_{mc} = 1$ avoid holdup problems associated with the costs ${}_p$ and ${}_m$, which are sunk when and deal with the end user . For ${}^o_{pm}$, there is also a holdup problem when deals with , but in this case other forces come into play. When someone chooses to be type , he considers his own benefit and cost, but neglects the fact that at the margin he makes it harder for other 's to meet 's and easier for 's to meet 's. In addition, having more 's increases , and that makes it harder for a type agent to trade when he does meet 's. Balancing these considerations delivers ${}^o_{pm}$.

Now suppose ${}''(\;)\quad 0$, while continuing to assume $(0) = 0$. It is interesting to go beyond linear (transferrable) utility, for various reasons, but here is a big one. Let $\hat{\ }$ 0 solve $(\hat{\ }) = \hat{\ }$. If an equilibrium payment is $\hat{\ }$ then the transfer is such that the cost to the payer exceeds the value to the payee. Hence, $\hat{\ }$ discourages, and symmetrically $\hat{\ }$ encourages, intermediation. This is because indirect trade entails two payments, to and to , rather than one, to . The nonlinear specification can be interpreted as transaction costs in the settlement process. Note $\hat{\ }$ is possible, since even with ( ) the surplus can be positive due to the gains from trading . Indeed, we do not impose $'(0)$ 1, so it may be that ( ) $\forall$ 0.

For tractability, with $''$ 0, we use Kalai's (1977) bargaining solution: when trades with , maximize 's surplus subject to getting a share $_{ij}$ of the total surplus.[10] Then we have

$$
\begin{aligned}
{}_p &= {}_c\ {}_{pc}[\ (\ {}_{cp}) - \ {}_{cp} + \ ] + \ {}_m(1 - \ )\ {}_{pm}[\ (\ {}_{mp}) - \ {}_{mp} + \ {}_1 - \ {}_0] - \ {}_p \\
{}_0 &= {}_p\ {}_{mp}[\ (\ {}_{mp}) - \ {}_{mp} + \ {}_1 - \ {}_0] \\
{}_1 &= {}_c\ {}_{mc}[\ (\ {}_{cm}) - \ {}_{cm} + \ + \ {}_0 - \ {}_1] - \ {}_m \\
{}_c &= {}_p\ {}_{cp}[\ (\ {}_{cp}) - \ {}_{cp} + \ ] + \ {}_m\ \ {}_{cm}[\ (\ {}_{cm}) - \ {}_{cm} + \ + \ {}_0 - \ {}_1]
\end{aligned}
$$

For simplicity, and efficiency, set $_{pc} = \ _{mc} = 1$ so that $_c = 0$ and $_{cp} = \ _{cm} = \ $. Then let $\ = \ (\ )$ and simplify the above equations to

$$
\begin{aligned}
{}_p &= {}_c\ + (1 - \ {}_c - \ )\ {}_{pm}\ (\ {}_{mp}) - \ {}_p && (13) \\
{}_0 &= \frac{{}_c\ (1 - \ {}_{pm})}{(1 - \ )\ {}_{pm}}\ (\ {}_{mp}) && (14) \\
{}_1 &= {}_c(\ + \ {}_0 - \ {}_1) - \ {}_m && (15)
\end{aligned}
$$

The solution method mimics that used above, although the algebra is more involved, which is why we use ( ) = as a benchmark model. The analog to

[10]This is not the definition of Kalai bargaining, it is a result about the outcome implied by his axioms, like maximizing the Nash product is a result about the outcome implied by his axioms. If $U(y) = y$, Nash and Kalai are the here; with $U'' < 0$, while we could use Nash, Kalai has some advantages (as Aruoba et al. 2007 argue in the context of a related model).

Lemma 1 (with the proof left as an exercise) is:

A (subgame perfect) class 0 equilibrium exists iff $_p \geq \ _c$ *and* $_p \geq$ $(\ _m)$, *where*

$$(\ _m) \equiv \quad + \ (\ _0)(1 - \ ) \tag{16}$$

and $_0$ *is given by the bargaining solution for* $_{mp}$ *with* $\ = 0$.

Notice $_p \geq \ (\ _m)$

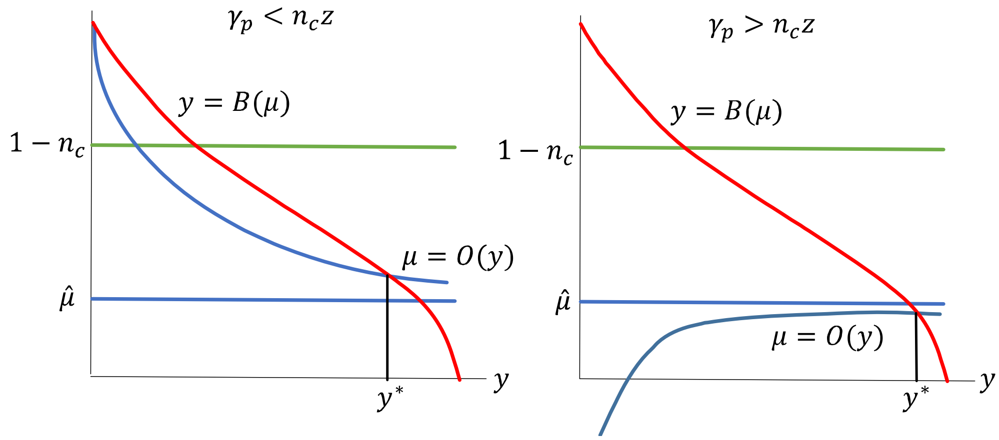


Figure 3: Equilibrium in $(\ _{mp}\ \ )$ space

With a general $\ (\ )$ we cannot eliminate $\ _{mp}$ from the equilibrium conditions, so we work with two curves in $(\ _{mp}\ \ )$ space representing bargaining and occupational choice. Setting $\ _0 = \ _p$ implies a quadratic we can solve for

$$= \frac{[2\ _{pm}(1-\ _c)+\ _c]\ \ (\ _{mp})+\ _{pm}\left(\ _c\ -\ _p\right)-\sqrt{\tilde{\ }}}{2\ _{pm}\ \ (\ _{mp})} \qquad (18)$$

where $\tilde{\ }$ is the discriminant. This defines a function $\ = \ (\ _{mp})$, for occupational choice. One can check $\ _{mp} \simeq -(\ _c\ -\ _p)$, where $\simeq$ means and have the same sign. As shown in Fig. 3, this traces a curve in $(\ _{mp}\ \ )$ space that slopes up or down, depending on the sign of $\ _c\ -\ _p$, but for all parameters $\lim_{y_{mp}\to\infty}\ (\ _{mp}) = \hat{\ } \in (0\ \bar{\ })$.

Next, using (14)-(15) to solve for $\ _1 - \ _0$ and eliminating it from the Kalai solution, $\ (\ _{mp}) = \ _{pm}[\ \ (\ _{mp}) + \ _1 - \ _0]$, we get $\ _{mp} = \ (\ )$, for bargaining. In fact, it can be solved for $\ = \ ^{-1}(\ _m)$ explicitly:

$$= \frac{\ _{pm}(\ _c\ -\ _m) - \Upsilon}{\ _{pm}(\ _c\ -\ _m) - \Upsilon + \ _c(1-\ _{pm})\ \ (\ _{mp})} \qquad (19)$$

where $\Upsilon \equiv (\ +\ _c)[\ _{pm}\ _{mp} + (1-\ _{pm})\ \ (\ _{mp})]$. This traces a downward-sloping curve, as shown in Fig. 3. The Appendix proves the following results:

γ

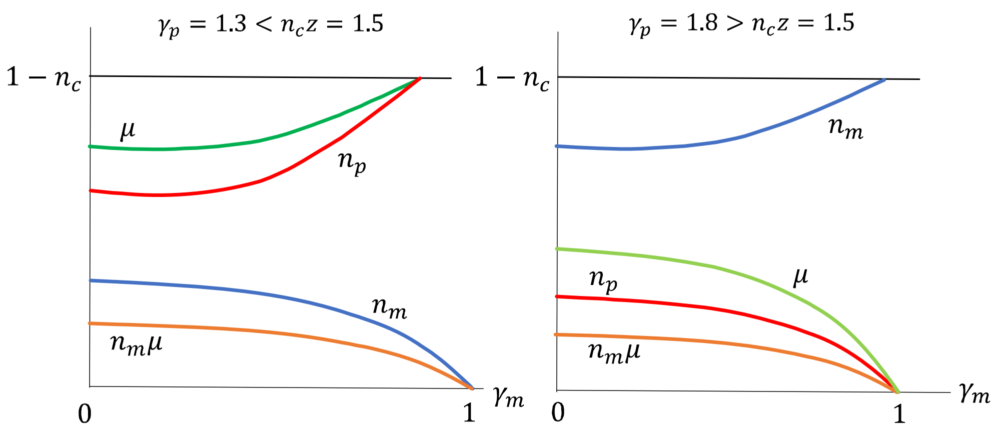


Figure 5: Effects of $_m$ in the nonlinear model

by the dashed and solid curves crossing; this is because nonlinearity tends to discourage intermediation when $_{mp}$ $\hat{}$ and encourage it when $_{mp}$ $\hat{}$. In the right panel of Fig. 4, the solid curves are $_{mp}$, and $_0$ as functions of $_p$ for the nonlinear model, while the dashed curves are for the linear model. The impact of $_m$ is shown in Fig. 5, where higher $_m$ implies lower (higher) $_m$ in the left (right) panel. These are general results, as was the case in the linear specification, as can be proved using the following easily-verified result:

An increase in $_p$ shifts the curve down and does not affect the curve in Fig. 3, while an increase in $_m$ shifts the curve down and does not affect the curve.

The next extension concerns transitions in class 2 equilft tTf1Tf.50TDl.72-6.72l1.08-6.72l1.32-6.8

become type , but agents cannot start as type with their own output, say, because they must spend to acquire the middleman technology. Here we work with the 's, rather than , since ${}_1$ is a state variable, with law of motion

$$\dot{}_1 = {}_0(1 - {}_c - {}_1 - {}_0) - {}_1 {}_c \tag{20}$$

In contrast, ${}_0$ can jump at any time to satisfy occupational choice, ${}_0 = {}_p$, just like vacancies jump in the well-known labor-market model of Pissarides (2000). The bargaining solution for ${}_{mp}$ is

$$({}_{mp}) = {}_{pm}[\ ({}_{mp}) - {}_{mp} + \Delta] \tag{21}$$

and the analogs to (13)-(15), without imposing steady state, are

$$\begin{aligned} {}_p &= {}_c + {}_0 \ ({}_{mp}) - {}_p + \dot{}_p & (22) \\ {}_0 &= (1 - {}_c - {}_1 - {}_0)\frac{1 - {}_{pm}}{{}_{pm}} \ ({}_{mp}) + \dot{}_0 & (23) \\ {}_1 &= {}_c(\ - \Delta) - {}_m + \dot{}_1 & (24) \end{aligned}$$

We now reduce this dynamic system to something manageable. First notice that ${}_p = {}_0$ implies $\dot{}_p = \dot{}_0$, and then from (22)-(23) the occupational choice condition becomes

$${}_c + {}_0 \ ({}_{mp}) - {}_p - (1 - {}_c - {}_0 - {}_1)\frac{1 - {}_{pm}}{{}_{pm}} \ ({}_{mp}) = 0 \tag{25}$$

Next, subtracting (23)-(24), we get

$$\Delta = {}_c(\ - \Delta) - {}_m + \dot{\Delta} - (1 - {}_c - {}_0 - {}_1)\frac{1 - {}_{pm}}{{}_{pm}} \ ({}_{mp}) = 0$$

Substituting (25) and simplifying, we arrive at

$$\dot{\Delta} = (\ + {}_c)\Delta + {}_m - {}_p + {}_0 \ ({}_{mp}) \tag{26}$$

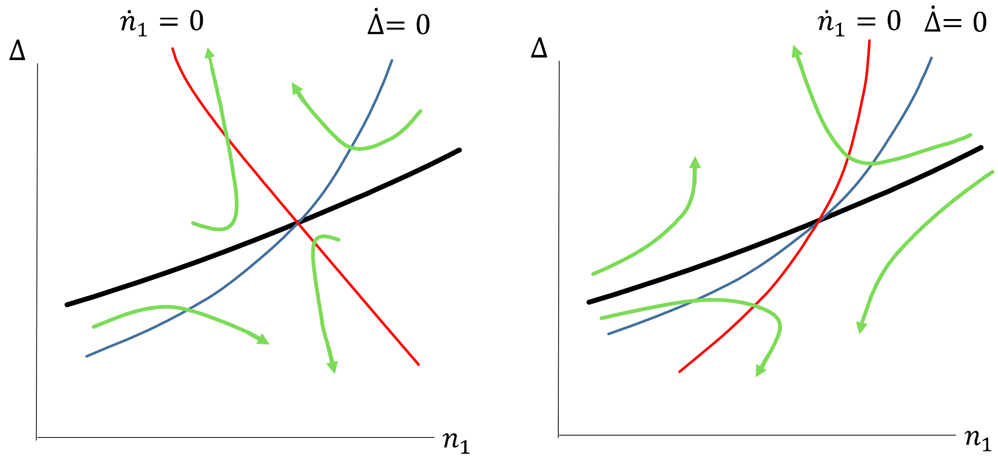


Figure 6: Saddle path stability

Then (20) and (26) define a two-dimensional system in ($_1$ Δ) space, where $_0$ and $_{mp}$ are functions of ($_1$ Δ) given by the free entry and bargaining conditions.

In Section 5 it was verified there exists a unique steady state, which is the intersection of the curves along which $\dot{}_1 = 0$ and $\dot{\Delta} = 0$. These curves have slopes after simplification given by

$$\frac{\Delta}{{}_1}|_{\dot{n}\ =0} = \frac{[(\ _0 + \ _c) + (1 - \ _c - \ _1 - 2\ _0)(1 - \ _{pm})]\,[(1 - \ _{pm})\ \ ' + \ _{pm}]}{(1 - \ _c - \ _1 - 2\ _0)\frac{U'}{U}[(1 - \ _{pm})(1 - \ _c - \ _1) - \ _0]\ _{pm}}$$
$$\frac{\Delta}{{}_1}|_{\dot{\Delta}\ =0} = \frac{(1 - \ _{pm})\,[(1 - \ _{pm})\ \ ' + \ _{pm}]}{(\ + \ _c)\,[(1 - \ _{pm})\ \ ' + \ _{pm}] + \ '(1 - \ _{pm})(1 - \ _c - \ _1)\ _{pm}}$$

The slope of the $\dot{\Delta} = 0$ curve is strictly positive. The slope of the $\dot{}_1 = 0$ curve can be positive or negative, but if it is positive one can check it is steeper than the $\dot{\Delta} = 0$ curve. Also note that $\dot{}_1$ $_1$ 0 and $\dot{\Delta}$ $_1$ 0. Hence, the system looks like Fig. 6. Whether the $\dot{}_1 = 0$ curve slopes down (left panel) or up (right panel), the steady state exhibits saddle path stability.

The class 2 steady state is a saddle point.

Therefore, given an initial condition for $\bar{}_1$, there is a unique initial $\bar{\Delta}$ such that ($_1$ Δ) transits to the steady state, and any $\Delta \neq \bar{\Delta}$ implies an explosive path that cannot be an equilibrium. So equilibrium, not only steady state, is unique – which was not a foregone conclusion.[12]

The theory applies to many types of middlemen with comparative advantage in storage or bargaining. But storing inventories is not always costly. Suppose is producing and is dealing in fine art. Then the net benefit of holding can be $_j = -{}_j$ 0, given art generates positive utility. If $_m$ $_p$, e.g., an art dealer, perhaps by charging admission to his gallery, gets more from the piece than the artist. If an art consumer/collector enjoys it even more, may retrade it, or he may prefer to keep it – an option not relevant in the baseline model with $_j$ 0 (note that never prefers to keep , regardless of $_p$, since as soon as estate flipping. All of these applications make it interesting to consider ${}_j$ 0. Moreover, in terms of theory, ${}_j$ 0 generates some novel results.

The dynamic programming equations are the same, but we need a new endogenous variable , for the probability that trades to . Also, ${}_1$ is still 's payoff to holding with the intention of trading it to , but he actually prefers to keep it if ${}_1 \quad - {}_j$. It is now possible in principle to have ${}_m = 1 - {}_c$ and ${}_p = 0$, but if so, then must hold on to (if he trades it he never gets again since ${}_p = 0$); in this case the no-deviation condition is $- {}_j \geq {}_p$ since the relevant deviation is to become type . Hence we have this:

$$
{}_m = \begin{cases} 0 & \text{if } {}_p \quad {}_0 \\ [0\ \ 1 - {}_c] & \text{if } {}_p = {}_0 \\ 1 - {}_c & \text{if } {}_p \quad - {}_m \end{cases} \quad \text{and} \quad = \begin{cases} 0 & \text{if } {}_1 \quad - {}_j \\ [0\ \ 1] & \text{if } {}_1 = - {}_j \\ 1 & \text{if } {}_1 \quad - {}_j \end{cases}
$$

The other change is that the possibility of 1 makes the steady state condition

$$
= \frac{1 - {}_c - {}_m}{1 - {}_c - {}_m + {}_c}
$$

We study steady state equilibria in terms of and ${}_m$, with $(\ ) =$ to ease the presentation. There are 9 candidates, shown in Table 1, none of which correspond to a class 0 outcome because production always dominates nonparticipation with ${}_j$ 0. If ${}_m = 0$, in the first row of Table 1, $= 1$ corresponds to a class 1 outcome in the baseline model, where there are no type agents on the equilibrium path, but if there were, off the equilibrium path, they set $= 1$. We call this a class 1^T equilibrium (indicates trades). Similarly, if ${}_m = 0$ we call $= 0$ a class 1^K equilibrium, because if there were a type with he would not trade it to (indicates keeps). And if ${}_m = 0$ we call $\in (0\ \ 1)$ a class 1^R equilibrium (indicates randomizes), but in fact this can be ruled out: only chooses $\in (0\ \ 1)$ if he is indifferent, which might happen if ${}_m \in (0\ \ 1 - {}_c)$ is set endogenously, but generically not if ${}_m$ is 0 or $1 - {}_c$.

$_m\backslash$	0	[0 1]	1
0	1^K	$\times$	1^T
[0 1 $-$ $_c$]	2^K	2^R	2^T
$1 -$ $_c$	$\times$	$\times$	$\times$

Table 1: Candidate equilibria with $_j = -$ $_j$ 0.

One can also rule out $_m = 1 -$ $_c$ and either $\in (0\ 1]$: if $_m = 1 -$ $_c$ there are no producers, so trading away leaves with a continuation value 0, which implies a profitable deviation because he can become type . We cannot rule out $_m = 1 -$ $_c$ and $= 0$, but we ignore it in what follows because it is a degenerate outcome with no production.[13] The remaining candidates are $_m \in [0\ 1 -$ $_c]$ and $= 1$, $= 0$ or $\in (0\ 1)$, called class 2, 2^K or 2^R (there are both type and , and either trades , keeps it or randomizes). The following is proved in the Appendix and illustrated in Fig. 7.

The Appendix defines $(\cdot)$, $(\cdot)$, $(\cdot)$, $\tilde{}_p$ *and* $^*_m$. *Class* 1^T *equilibrium exists iff* $_m \geq$ (0) ($_p$). *Class* 1^K *exists iff* ($_p$) $\leq$ $_m \leq$ (0). *Class* 2^K *exists iff* $_m \leq$ ($_p$) ($_p$). *Class* 2^R *exists iff* ($_p$) $_m$ (1 $-$ $_c$). *Class* 2^T *exists iff* $^*_m \leq$ $_m \leq$ ($_p$).

The left panel of Fig. 7, with $\tilde{}_p$ 0, is simple: $_m$ ($_p$) $\Rightarrow$ $_m = 0$; and $_m$ ($_p$) $\Rightarrow$ $_p$ $_m$ 0, but type agents keep . In the right panel, with $\tilde{}_p$ 0, those outcomes are still possible, but so are class 2^T and 2^R, with active intermediation. Clearly we lose uniqueness. Is there something about financial intermediation that contributes to this? Yes. Heuristically, the multiplicity is due to a strategic complementarity. When keeps with probability $1 -$ 0, the

[13] This equilibrium, with type M agents simply sitting on x, can be shown to exist iff $\gamma_m \leq k(\gamma$), where $k(\cdot)$ is defined below. When it exists, there coexists another equilibrium, so we do not need it to establish existence. However, we ignore it mainly to avoid cluttering the graphs; we do not claim it should be ignored based on stability considerations, even if one might ask, how can all the M's be holding x when there are no P's to produce it? The answer is that n > 0 along the transition path, with n $\to 0$ only as $t \to \infty$.

This project has continued the development of search-and-bargaining theories of intermediation. We built on the classic model of Rubinstein and Wolinsky (1987), extended to allow general bargaining powers and costs, but rather than fixing the numbers of producers and middlemen we let agents choose their types. This is natural for investigating many issues.[14] The theory delivered clean and sometimes surprising results – e.g., $_m$ $_m$ 0 is possible, for reasons explained above. We established existence and generic uniqueness for the baseline model, although with $_j$ 0 an interesting multiplicity can emerge. We discussed how middlemen can be essential, and showed equilibrium is efficient iff bargaining powers are just right; otherwise there can be too much or too little intermediation. Extensions including strictly concave utility and dynamics were presented.

Many other extensions and applications should be possible. Clearly one would like to go beyond unit inventories, just like it was desirable to move beyond unit inventories in monetary models like Kiyotaki and Wright (1993). This has been accomplished in search-based theories of money and finance by several authors using a variety of techniques (again see Nosal and Rocheteau 2011 or Lagos et al. 2015). Something similar could work for middlemen, too, if one were willing to adopt similar assumptions. This is left for future work. Based on the results developed here, we think the framework should become a benchmark model in intermediation theory, and in search theory more generally.

[14] One issue is that the only way to get more intermediaries here is to have fewer producers, capturing a very real economic trade-off (e.g., more MBA's means fewer engineers). Also, our setup eliminates some effects in earlier models that are artifacts of simplifying assumptions, one of which concerns the restriction of M's inventory be 0 or 1. In other models, when M takes P's good, the latter can produce again, leading to more output. That is not relevant here, because if M does not take P's good, he can become a producer and make his own x. Hence, intermediation is useful not merely because it gets around the unit-inventory restriction. Other features of the model also allow one to consider additional issues, including $U'' < 0$, which captures the idea that payments are not necessary perfect (linear), and this naturally affects the incentives to engage in intermediation. Dynamics are also interesting, with n_m, n and μ varying along the saddle path over time, somewhat similar to Weill (2007).

[1] S. Aruoba, G. Rocheteau and C. Waller (2007) "Bargaining and the Value of Money," *JME* 54, 2636-55.

[2] G. Biglaiser (1993) "Middlemen as Experts," *RAND* 24, 212-223.

[3] G. Camera (2001) "Search, Dealers, and the Terms of Trade," *RED* 4, 680-694.

[4] D. Duffie, N. Gârleanu and L. Pederson (2005) "Over-the-Counter Markets," *Econometrica* 73, 1815-47.

[5] A. Geromichalos and L. Herrenbrueck (2016) "Monetary Policy, Asset Prices, and Liquidity in Over-the-Counter Markets," *JMCB* 48, 35-79.

[6] A. Hosios (1990) "On the Efficiency of Matching and Related Models of Search and Unemployment," *RES* 57, 279-298.

[7] Jacobson, N. (2009), *Basic Algebra 1*, 2nd ed. Dover.

[8] A. Johri and J. Leach (2002) "Middlemen and the Allocation of Heterogeneous Goods," *IER* 43, 347-361.

[9] E. Kalai (1977) "Proportional Solutions to Bargaining Situations: Interpersonal Utility Comparisons," *Econometrica* 45, 1623-30.

[10] Y. Li (1998) "Middlemen and Private Information," *JME* 42, 131-159.

[11] R. Lagos, G. Rocheteau and R. Wright (2015) "Liquidity: A New Monetarist Perspective," *JEL*, in press.

[12] R. Lagos and G. Rocheteau (2009) "Liquidity in Asset Markets with Search Frictions," *Econometrica* 77, 403-26.

[13] A. Masters (2007) "Middlemen in Search Equilibrium," *IER* 48, 343-62.

[14] D. Mortensen (1982) "Property Rights and Efficiency of Mating, Racing, and Related Games," *AER* 72, 968-79.

[15] E. Nosal and G. Rocheteau (2011) *Money, Payments, and Liquidity*. MIT Press.

[16] E. Nosal, Y.-Y. Wong and R. Wright (2015) "More on Middlemen: Equilibrium Entry and Efficiency in Intermediated Markets," *JMCB* 47, 7-37.

[17] C. Pissarides (2000) *Equilibrium Unemployment Theory.* MIT Press.

[18] A. Rubinstein and A. Wolinsky (1987) "Middlemen," *QJE* 102, 581-594.

[19] A. Shevchenko (2004) "Middlemen," *IER* 45, 1-24.

[20] E. Smith (2004) "Intermediated Search," *Economica* 71, 619-636.

[21] A. Trejos and R. Wright (2015) "Search-Based Models of Money and Finance: An Integrated Approach," *JET*, in press.

[22] C. Tse (2009) "The Spatial Origin of Commerce," mimeo.

[23] M. Watanabe (2010) "A Model of Merchants," *JET* 145, 1865-1889.

[24] P.-O. Weill (2007) "Leaning against the Wind," *RES* 74, 1329-14.

[25] R. Wright (1995) "Search, Evolution and Money," *JEDC* 19, 181-206.

[26] R. Wright and Y.-Y. Wong (2014) "Buyers, Sellers and Middlemen: Variations on Search-Theoretic Themes," *IER* 55, 375-398.

Here we provide proofs for results that are not obvious.

: Class 0 and class 2 equilibria coexist in the region where $_p \geq \bar{}_p$ and $_m$ $(_p)$, but we claim the former is not subgame perfect. Notice $_m$ $\bar{}_m$ in this region, and consider a class 0 candidate equilibrium. Suppose a nonparticipant deviates and produces. When he meets another nonparticipant, which happens with positive probability, that agent has a strict incentive to accept his good and act like type because $_m$ $\bar{}_m$ (i.e., it is not credible to think he would reject it). This constitutes a profitable deviation. ■

: There are three ways for a convex $( ) = 0$ to have solutions in $(0\ \bar{})$: (a) one root with (0) 0 $(\bar{})$; (b) one root with (0) 0 $(\bar{})$; (c) two-roots, which requires (c1) $(\bar{})$ 0, (c2) (0) 0, (c3) $'(\bar{})$ 0, (c4) $'(0)$ 0, and (c5) $(^*)$ 0, where $'(^*) = 0$. Notice that

$$(0) = (1 - {}_c)\ {}_{pm}(\bar{}_m - {}_m$$

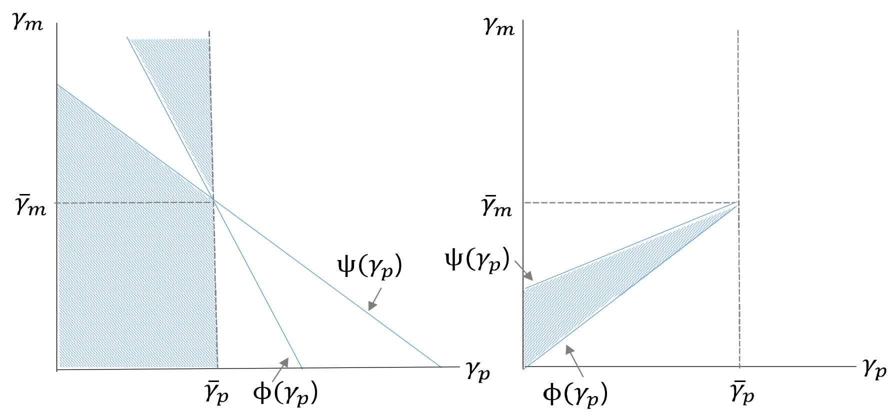


Figure 8: The functions $(\ _p)$ and $(\ _p)$

(c3) and (c4) are satisfied. The parameter set consistent with the conditions c(1), c(3) and c(4) is given by $\mathcal{S}_1 \equiv \{(\ _p\ \ _m)|0\ \ \ _p \leq \bar{\ }_p\ \ (\ _p)\ \ \ _m\ \ \ (\ _p)\}$, shown in the right panel of Fig. 8

Similarly, let $\mathcal{S}_2$ be the set consistent with (c5). To characterize $\mathcal{S}_2$, the discriminant of $(\ )$, , can itself be written as a quadratic in $_m$ given $_p$, $\hat{\ }(\ _m|\ _p) = \hat{\ }_1\ {}^2_m + \hat{\ }_2\ _m + \hat{\ }_3$, where

$$
\begin{aligned}
\hat{\ }_1 &= \ _c^2 + 4\ _c(1 - \ _c)\ _{pm}\ _{mp} \\
\hat{\ }_2 &= -2\bar{\ }_m[\ _c^2 + 4\ _c(1 - \ _c)\ _{pm}\ _{mp}] \\
&\quad -2\ _c(\bar{\ }_p - \ _p)[(\ + \ _c\ _{mc} - \ _c\ _{mp})(1 - 2\ _{pm}) - 2\ _{mp}\ _{pm}] \\
\hat{\ }_3 &= \bar{\ }^2_m[\ _c^2 + 4\ _c(1 - \ _c)\ _{pm}\ _{mp}] + (\bar{\ }_p - \ _p)^2(\ + \ _c\ _{mc} - \ _c\ _{mp}) \\
&\quad +2\ _c\bar{\ }_m(\bar{\ }_p - \ _p)[(\ + \ _c\ _{mc} - \ _c\ _{mp})(1 - 2\ _{pm}) - 2\ _{mp}\ _{pm}]
\end{aligned}
$$

Since $\hat{\ }_1\ \ 0$, $\hat{\ }$ is strictly convex. Also, it is straightforward to show that $\hat{\ }(\bar{\ }_m|\ _p)\ \ 0\ \forall\ _p \in [0\ \bar{\ }_p)$. Thus, since $\hat{\ }$ is strictly convex and $\hat{\ }(\bar{\ }_m|\ _p)\ \ 0$, $\mathcal{S}_2 \neq \varnothing \Rightarrow \hat{\ }(0|\ _p)\ \ 0 \Rightarrow \hat{\ }_3\ \ 0$, as shown in the left panel of Fig. 9.

It can be shown that $\hat{\ }(\ _m|\bar{\ }_p)\ \ 0\ \forall\ _m \in [0\ \bar{\ }_m)$ and $\hat{\ }(\bar{\ }_m|\bar{\ }_p) = 0$. Since $\hat{\ }$ is continuous in $(\ _m\ \ _p)$, $\hat{\ }(\ _m|\ _p)\ \ 0$ for some $_m\ \ \bar{\ }_m$ if $\bar{\ }_p - \ _p$ is small. The admissible set of $_p$ for which $\hat{\ }(\ _m|\ _p)\ \ 0$ is pinned down by the lower root of $\hat{\ }(\ _m|\ _p) = 0$ being positive, i.e., $\underline{\ }_m(\ _p) = (-\hat{\ }_2 - \sqrt{\Lambda})\ 2\hat{\ }_1\ \ 0$, where $\Lambda = \hat{\ }^2_2 - 4\hat{\ }_1\hat{\ }_3\ \ 0$. One can show $\underline{\ }_m(\ _p)\ \ 0 \Rightarrow \hat{\ }_2\ \ 0 \Rightarrow\ _p\ \ \underline{\ }_p$ with

$$\underline{\ }_p \equiv \bar{\ }_p + \bar{\ }_m[\ _c + 4(1 - \ _c)\ _{pm}\ _{mp}][(\ + \ _c\ _{mc} - \ _c\ _{mp})(1 - 2\ _{pm}) - 2\ _{mp}\ _{pm}]$$

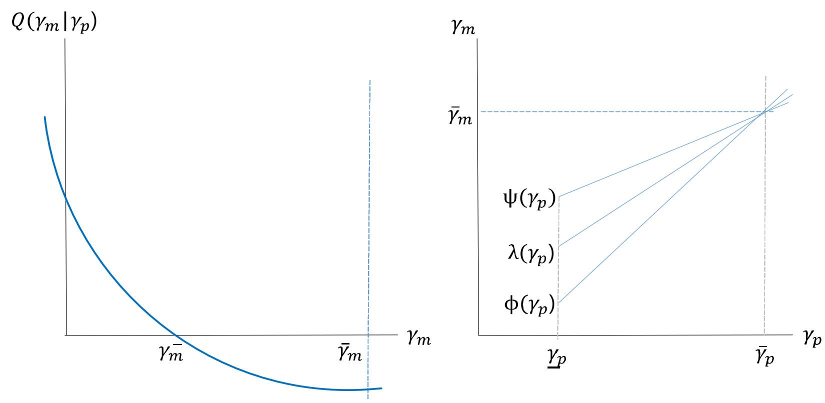


Figure 9: The functions $\hat{}({}_m| {}_p)$ and $({}_p)$

Hence, for a given ${}_p$, the set of ${}_m$ such that $\hat{}({}_m| {}_p) \quad 0$ is $[0 \quad {}_{\bar{m}}({}_p))$. Therefore, $\mathcal{S}_2 = \{({}_p \quad {}_m)|_{-p} \quad {}_p \quad {}^{-}{}_p \; 0 \quad {}_m \quad {}_{\bar{m}}({}_p)\}$. Suppose for a given ${}_p$ there exists ${}_{\bar{m}}({}_p) \quad 0$ such that $\hat{}({}_{\bar{m}}({}_p)) = 0$. We express the lower root as ${}_{\bar{m}}({}_p) = \; ({}_p)$, where

$$({}_p) \equiv {}^{-}{}_m + ({}^{-}{}_p - \; {}_p) \frac{{}_c[(\; + \; {}_c \; {}_{mc} - \; {}_c \; {}_{mp})(1 - 2 \; {}_{pm}) - 2 \; {}_{mp} \; {}_{pm}] - \sqrt{\Lambda}}{{}_c{}^2 + 4 \; {}_c(1 - \; {}_c) \; {}_{pm} \; {}_{mp}}$$

One can show ${}'({}_p) \quad 0$. The right panel of Fig. 9 depicts ${}_m = \; ({}_p)$, ${}_m = \; ({}_p)$ and ${}_m = \; ({}_p)$. Since $\hat{} \equiv \quad 0 \Rightarrow \; {}_m \quad ({}_h)$, a necessary condition for case (c) is ${}'({}_p) \quad {}'({}_p)$, as in the right panel of Fig. 9.

Hence, (c) requires $\mathcal{S}_1 \cap \mathcal{S}_2 \neq \varnothing$ and ${}'({}_p) \quad {}'({}_p)$. But the latter inequality can be simplified to

$$\begin{aligned} ({}_{mc} - \; {}_{mp})[{}_c + 4(1 - \; {}_c) \; {}_{pm} \; {}_{mp}] \quad & [{}_c({}_{mc} - \; {}_{mp})(1 - 2 \; {}_{pm}) - 2 \; {}_{mp} \; {}_{pm}] \\ & - \{[{}_c({}_{mc} - \; {}_{mp})(1 - 2 \; {}_{pm}) - 2 \; {}_{mp} \; {}_{pm}]^2 \\ & - ({}_{mc} - \; {}_{mp})[{}_c + 4(1 - \; {}_c) \; {}_{pm} \; {}_{mp}]\}^{1/2} \end{aligned}$$

when we ignore terms with $\;$, which only strengthens the inequality. This inequality implies

$$-1 + \; {}_c({}_{mc} - \; {}_{mp}) \quad 4 \; {}_c \; /$$

: It is straightforward to derive $\quad (\;) \quad {}_p \quad 0$, so consider the effect of ${}_m$. In the particular case of ${}_p = {}^-{}_p$, the relevant root is

$$= \frac{2(1- \; {}_c) \; {}_{pm} + \; {}_c - [4(1- \; {}_c) \; {}_{pm} \; {}_c(1- \; {}_{pm} \; {}_c) + \; {}_c^2]^{1/2}}{2 \; {}_{pm}} \equiv \; \tilde{}$$

Hence, $\quad {}_m = 0$ when ${}_p = {}^-{}_p$. More generally,

$$\frac{(\;)}{{}_m} = {}_c + {}_{pm}[2(1- \; {}_c) \; - (1- \; {}_c) - \; {}^2]$$

which vanishes when $= \tilde{}$ or ${}_p = {}^-{}_p$. Moreover,

$$\frac{(\;)}{{}_m}\Bigg|_{\mu=\tilde{\mu}} = {}_c + {}_{pm}2(1- \; {}_c) - 2 \; {}_{pm} \quad 0$$

where $= \tilde{}$ is inserted after the derivatives are taken. This implies $\quad {}_m \quad 0$ if ${}_p \quad {}^-{}_p$ and $\quad {}_m \quad 0$ if ${}_p \quad {}^-{}_p$. ■

7: As $(\; {}_m \;) \quad {}_m = (\; {}_m \;) \quad \times \quad {}_m$ we need to sign $(\; {}_m \;) \quad$. Notice ${}_m \; = \; - \; {}_c \quad (1- \;)$, which implies

$$\frac{(\; {}_m \;)}{} \simeq (1- \;)^2 - \; {}_c \simeq \; {}_p - \; {}_c$$

where the second equality uses (10) to eliminate $(1- \;)^2$ and $\simeq$ means and take same sign. When ${}_p \quad {}_c$, $\quad {}_m \quad 0$ and $(\; {}_m \;) \quad 0$, so $(\; {}_m \;) \quad {}_m \quad 0$; when ${}_p \quad {}_c$, $\quad {}_m \quad 0$ and $(\; {}_m \;) \quad 0$, so again $(\; {}_m \;) \quad {}_m \quad 0$. ■

3: The efficient and equilibrium outcomes only correspond in general if ${}_{mc} = {}_{pc} = 1$, as that needed for ${}^-{}_p = {}^-{}_m = \; {}_c$. Given ${}_{mc} = {}_{pc} = 1$,

$$(\; {}_p) = \frac{- \; {}_c^2 \; + [1- \; {}_{pm}(1- \; {}_c)] \; {}_p}{(1- \; {}_c)(1- \; {}_{pm})}$$

$$(\; {}_p) = \frac{{}_c \; [\; {}_c + \; {}_{pm}(1- \; {}_c)] - \; {}_c \; {}_p}{(1- \; {}_c) \; {}_{pm}}$$

If ${}^o_{pm} = 1$ then $(\; {}_p) = {}^0(\; {}_p)$; so for $(\; {}_p \; {}_m) \in {}^o_0$, ${}_j = {}^o_j = 0$. If ${}^o_{pm} = 0$ then $(\; {}_p) = {}^0(\; {}_p)$; so for $(\; {}_p \; {}_m) \in {}^o_1$, again ${}_j = {}^o_j$. If ${}^o_{pm} \in (0 \; 1)$ then ${}_m \leq (\; {}_p)$ implies ${}_m \leq {}^o(\; {}_p)$ and ${}_m \leq (\; {}_p)$ implies ${}_m \leq {}^o(\; {}_p)$. If we set

$_{mc} = \ _{pc} = 1$ and equate the roots of (8) and (10), so that $\ = \ ^o$, we get $^o_{pm}$. To check $^o_{pm} \in (0\ 1)$, note the numerator is positive since $^o \quad 1 - \ _c$, and the denominator is even bigger since $^o_m \quad 0$ requires $_m \quad _p$. ■

There are again three ways for $\tilde{\ }(\quad _{mp}) = 0$ to have a solution in $(0\ ^-)$: (a) one root with $\tilde{\ }(0\ \ _0) \quad 0 \quad \tilde{\ }(^-\ ^-)$; (b) one root with $\tilde{\ }(0\ \ _0) \quad 0 \quad \tilde{\ }(^-\ ^-)$; and (c) two roots, which requires (c1) $\tilde{\ }(0\ \ _0) \quad 0$, (c2) $\tilde{\ }(^-\ ^-) \quad 0$, (c3) $\tilde{\ }(\quad _{mp}|\ = \ ^-) \quad 0$, (c4) $\tilde{\ }(\quad _{mp}|\ = 0) \quad 0$, and (c5) $\tilde{\ }(\ ^*\quad _{mp}) \quad 0$, where $\tilde{\ }(\ ^*\quad _{mp}) \quad = 0$. Notice

$$\begin{aligned} \tilde{\ }(0\ \ _0) &= \ _{pm}[\ _c - \ _p + \ (\ _0)(1 - \ _c)] \\ \tilde{\ }(^-\ ^-) &= \ _c[\ _{pm}(\ _c - \ _p) - \ (^-)(1 - \ _c)(1 - \ _{pm})] \end{aligned}$$

As in Lemma 3, it is easy to check that case (a) is not possible.

Turning to case (c), (c1) implies $_p \quad (\ _m)$ and (c2) implies $_p \quad (\ _m)$. For (c3) and (c4), we have

$$\frac{\tilde{\ }(\quad _{mp})}{} = 2\ _{pm} \quad (\ _{mp}) - (\ _c - \ _p)\ _{pm} - \ (\ _{mp})[\ _c + 2(1 - \ _c)\ _{pm}]$$

We need this positive at $\ = \ ^-$, which means $_p \quad \equiv \ _c - \ (^-)\ _c\ _{pm}$, and at $\ = 0$, which means $_p \quad _c + \ (\ _0)[\ _c + 2(1 - \ _c)\ _{pm}]\ _{pm}$. Given (c2), (c1) and (c4) are not binding. Also, (c2) and (c3) imply $_p$ is between and , which holds iff $_{pm} \quad (1 - 2\ _c) \quad (1 - \ _c)$. Assume this is true and consider (c5). To get *, solve $\quad = 0$ to get

$$\begin{aligned} \tilde{\ }(\ ^*\quad _{mp}) \simeq\ & -(\ _c - \ _p)[(\ _c - \ _p)\ _{pm} + 2\ _c\ (\ _{mp})(1 - 2\ _{pm})] \\ & - \ (\ _{mp})^2\ _c[1 + 4\ _{pm}(1 - \ _{pm})(1 - \ _c)] \end{aligned}$$

We need $\tilde{\ }(\ ^*\quad _{mp}) \quad 0$. Although it is an abuse of notation, let $\tilde{\ }(\ ^*\quad _{mp}) \equiv \tilde{\ }(\ _p) \quad 0$ where

$$\begin{aligned} \tilde{\ }(\ _p) = & - \ _{pm}\ ^2_p + 2\ _c[\ (\ _{mp})(1 - 2\ _{pm}) + \ _{pm}\ ]\ _p - \ ^2_c\ ^2\ _{pm} \\ & - \ ^2_c\ \ (\ _{mp})(1 - 2\ _{pm}) - \ _c\ (\ _{mp})^2[1 + 4\ _{pm}(1 - \ _{pm})(1 - \ _c)] \end{aligned}$$

For (c5) we seek the set of $_p$ such that $\tilde{\ }(\ _p) \quad 0$. There are three possibilities: (c5.1) one root with $\tilde{\ }(\ ) \quad 0 \quad \tilde{\ }(\ )$; (c5.2) one root with $\tilde{\ }(\ ) \quad 0 \quad \tilde{\ }(\ )$

and $\tilde{\ }(\ ^*_p)\quad 0$, where $\tilde{\ }'(\ ^*_p) = 0$. Given $\ _p = \quad$ and $\ _c - \ _p = \ (^-)\ _c\ \ _{pm}$,

$$\tilde{\ }(\ ) = -\ (^-)^2 \frac{\ _c^2}{\ _{pm}}[1 + 2(1 - 2\ _{pm})] - \ (^-)^2\ _c[1 + 4\ _{pm}(1 - \ _{pm})(1 - \ _c)] \quad 0$$

Given $\ _p = \ (\ _m)$ and $\ _c - \ _p = \ (^-)(1 - \ _{pm})(1 - \ _c)\ \ _{pm}$,

$$\tilde{\ }(\ ) \simeq -\ (^-)^2\{(1 - \ _{pm})(1 - \ _c)[1 + \ _c - \ _{pm}(1 + 3\ _c) + 4\ _c\ _{pm}^2] + \ _c\ _{pm}\} \quad 0$$

for $(1 - 2\ _c)\ (1 - \ _c)\quad \ _{pm}\quad 0$. This rules out (c5.1) and (c5.2). To check (c5.3), consider

$$\tilde{\ }'(\ _p) = -2\ _{pm}\ _p + 2\ _c[\ (\ _{mp})(1 - 2\ _{pm}) + \ _{pm}\ ]$$

Now $\tilde{\ }'(\ _p)\quad 0$ at $\ _p = \quad$, and $\tilde{\ }'(\ _p)\quad 0$ at $\ _p = \ (\ _m)$. As $\tilde{\ }'(\ )\quad 0$ violates (c5.3), there is no $\ ^*_p$ between and such that $\tilde{\ }(\ ^*_p)\quad 0$. ■

We need and in Fig. 3 cross at $(\ _{mp}\ ) \in (0\ \infty) \times (0\ ^-)$, plus $\ _m\quad \ _c$. For $\ \in (0\ ^-)$, we check $\tilde{\ }(0\ \ _0)\quad 0\quad \tilde{\ }(^-\ ^-)$, where $\ _0 = \ (0)$ and $^- = \ (^-)$. Now $\tilde{\ }(0\ \ _0)\quad 0$ iff $\ _p\quad (\ _m)$. At $\ _m = \ _c$, bargaining implies $\ _0 = 0$, and $\ _p\quad (\ _m)$ becomes $\ _p\quad \ _c$. As we lower $\ _m$,

: In class 2 equilibrium we have

$$= \frac{-(\ +\ _c)(1-\ _{pm})\quad (\ _{mp})}{-\ (1-\ _{pm})\quad (\ _{mp})} \equiv \ ^*$$

with $\ = \ _{pm}(\ _c - \ _m) - (\ + \ _c)\ _{pm}\ _{mp}\quad 0$, from the bargaining solution. Note $\quad 0 \Rightarrow \quad (\ + \ _c)(1- \ _{pm})\quad (\ _{mp})$, and $\quad ^- \Rightarrow$ $(1+\ )(1-\ _{pm})\quad (\ _{mp})$. Then

$$\frac{(\ _{mp})}{\ _{mp}} = -\frac{'\ _{pm}\left(\ _c - \ _p\right)}{\sqrt{\tilde{\ }}}(1-\ )$$

$$\frac{^{-1}(\ _{mp})}{\ _{mp}} = -\frac{\ _c(1-\ _{pm})}{[\ -\ (1-\ _{pm})\ ]^2}[\quad ' + \ _{pm}(\ + \ _c)\ ]$$

If $\ _c \quad \ _p$ the equilibrium is obviously unique. If $\ _c \quad \ _p$, we claim $\ _{mp} \quad ^{-1}\quad \ _{mp}$ when they cross. To verify this, insert $\ = \ ^*$ to get

$$\frac{(\ _{mp})}{\ _{mp}} = -\frac{'\ _{pm}\left(\ _c - \ _p\right)}{\sqrt{\tilde{\ }}}\frac{(1-\ _{pm})}{-\ (1-\ _{pm})}$$

where $\tilde{\ }$ is the discriminant of $\tilde{\ }(\quad _{mp})$. Using (18) to replace $\sqrt{\tilde{\ }}$ and inserting $\ = \ ^*$, we get

$$\frac{(\ _{mp})}{\ _{mp}} = -\frac{'\ _{pm}\left(\ _c - \ _p\right)\ _c(1-\ _{pm})}{[\ -\ (1-\ _{pm})\ ]\,\Omega}$$

where

$$\Omega \equiv [2\ _{pm}(1-\ _c) + \ _c]\quad + \ _{pm}\left(\ _c - \ _p\right) - \frac{2\ _{pm}\ [\ -(\ +\ _c)(1-\ _{pm})\ ]}{-\ (1-\ _{pm})}$$

In equilibrium, $\ = \ (\ _c - \ _m) - (\ + \ _c)\quad ^*$ and $\ = \ (\ ^*)$ solves

$$\begin{aligned} &[\ -(\ +\ )(1-\ )\ ]^2 + [\ -\ (1-\ )\ ]^2[\ -\ _p + (1-\ )\ ] \\ = &\ [\ -(\ +\ )(1-\ )\ ][\ -\ (1-\ )\ ]\{[2\ (1-\ )+\ ]\ +\ \left(\ -\ _p\right)\} \end{aligned}$$

Routine algebra implies $\quad (\ ) \quad - \quad ^{-1}(\ )\quad$ is proportional to

$$\begin{aligned} &\left(\ -\ _p\right)[\ -\ (1-\ )\ ][\ '\ (1-\ ) + (\ +\ )\ ] \\ +&[\ ' + \ (\ +\ )\ ]\ \{\ [\ -\ (1-\ )\ ] + 2\ [(1+\ )(1-\ )\ -\ ]\} \end{aligned}$$

Since $(1+\ )(1-\ )\qquad\qquad(1-\ )\ $, in equilibrium, this is positive, thus establishing the desired result. ■

: We consider each class of equilibrium from Table 1 in turn. Consider first a class 1^K equilibrium, where $_m = \ = 0$ and

$$
\begin{aligned}
{}_p &= \ {}_c\ {}_{pc}\ -\ {}_p \\
{}_0 &= (1-\ {}_c)\ {}_{mp}(\ {}_1 -\ {}_0) \\
{}_1 &= \ {}_c\ {}_{mc}(\ +\ {}_0 -\ {}_1) -\ {}_m
\end{aligned}
$$

Now $_1 \leq -\ _m$ iff $_m \leq\ (0)$, where $(\ _m) \equiv -\ [\ +(1-\ _c -\ _m)\ _{mp}]$ and $_p \geq\ _0$ iff $_m \geq\ (\ _p)$. Hence, the equilibrium exists under the stated conditions. Similarly, class 1^T equilibrium exists iff $_m \geq\ (0)$ and $_m \geq\ (\ _p)$.

Now consider $\ = 0$ and $_m \in (0\ 1-\ _c)$, a class 2^K equilibrium, which requires $_1 \leq -\ _m$ and $_p =\ _0$. The latter solves for

$$
{}_m = \frac{(1-\ {}_c)\ {}_{mp}(\bar{}_m -\ {}_m) - [\ +\ {}_c\ {}_{mc} + (1-\ {}_c)\ {}_{mp}](\bar{}_p -\ {}_p)}{{}_{mp}(\bar{}_m -\ {}_m - \bar{}_p +\ {}_p)}
$$

One can check $_m\quad 1-\ _c$. Also, $_m\quad 0$ requires either: (i) the denominator and numerator are both positive, which is true iff $_m\quad (\ _p)$; or (ii) they are both negative, which is true iff $_m\quad (\ _p) \equiv \bar{}_m - \bar{}_p +\ _p$. We also need $_1 \leq -\ _m$, which is true iff

$$
\_(\ {}_m) = \ {}_m^2 + [\ \ -(\bar{}_m - \bar{}_p +\ {}_p)]\ {}_m - \bar{}_m(\ \ + \bar{}_p -\ {}_p) \geq 0
$$

Note $\_(\ _m)$ is convex, $\_(0)\quad 0$ and $\_(\ _m^*)\quad 0$ where $_m^*\quad 0$ solves $\_'(\ _m^*) = 0$. Thus, $\_(\ _m) \geq 0$ iff $_m \leq\ (\ _p)$, where where $(\ _p) \equiv -(\ \ + \bar{}_p) +\ _p$ is the lower root of $\_(\ _m)$. Note it is linear and lies below $(\ _p)$; hence, $_m\quad (\ _p)$ cannot occur. In sum, the equilibrium exists iff $_m \leq\ (\ _p)\quad (\ _p)$.

Now consider $\ = 1$ and $_m \in (0\ 1-\ _c)$, a class 2^T equilibrium. This requires $_1 \geq -\ _m$ and $_p =\ _0$. The latter reduces to $\bar{}(\ _m) = \bar{}\ _m^2 + \bar{}\ _m + \bar{} = 0$, where

$$
\begin{aligned}
\bar{} &= \ {}_{mp}[\ {}_m -\ (\ {}_p)] \\
\bar{} &= -\ {}_{mp}(2-\ {}_c)[\ {}_m -\ (\ {}_p)] - (\ +\ {}_c\ {}_{mc})(\bar{}_p -\ {}_p) +\ {}_c\ {}_{pm}(\bar{}_m -\ {}_m) \\
\bar{} &= \ {}_{mp}(1-\ {}_c)[\ {}_m -\ (\ {}_p)] + (\ +\ {}_c\ {}_{mc})(\bar{}_p -\ {}_p)
\end{aligned}
$$

As usual, the upper root and two root case are not possible, so consider the lower root $_m$. Now $_m$ 0 exists iff $_m$ $(_p)$, and $_m$ $1-$ $_c$ iff $_m$ $(_p)$. Since $(_p)$ $(_p)$, the binding condition is $_m$ $(_p)$.

Next, to check $_1 \geq -$ $_m$, substitute the root of $\bar{}(_m) = 0$ into $_m \geq (_m)$ to get a cubic $(_m) = {}^3_m + \tilde{}\ {}^2_m + \tilde{}\ _m + \tilde{} \geq 0$, where

$$
\begin{aligned}
\tilde{} &= -\ (\ _c - 2\ ) -\ (\ _p) \\
\tilde{} &= -\ ^2[\ +\ _{mp}(1-\ _c)][\ _c(1-\ _{mp}) -\ +\ _{mp}] +\ ^2\ ^2_{mp}(1-\ _c) \\
&\quad + \{\ _{pm}\bar{}_m - (\bar{}_p -\ _p)(\ +\ _c\ _{mc}) +\ _{mp}(2-\ _c)\ (\ _p) \\
&\quad -2[\ +\ _{mp}(1-\ _c)]\ (\ _p)\} \\
\tilde{} &= -\ ^2\ ^2_{mp}(1-\ _c)\ (\ _p) +\ ^2\ _{mp}(\bar{}_p -\ _p)(\ +\ _c\ _{mc}) \\
&\quad +\ ^2[\ +\ _{mp}(1-\ _c)][\ _{pm}\bar{}_m - (\bar{}_p -\ _p)(\ +\ _c\ _{mc}) +\ (\ _p)\ (\ _{mp} -\ )]
\end{aligned}
$$

To solve the cubic, we employ Cardano's method (see Jacobson 2009, p. 210). First, rewrite $(_m) = 0$ using the transformation $= \ _m + \tilde{}\ 3$ to get

$$
^3 + \frac{3\tilde{} - \tilde{}^2}{3} + \frac{2\tilde{}^3 - 9\tilde{}\tilde{} + 27\tilde{}}{27} = 0
$$

Cardano's method implies there is one real root given by

$$
\begin{aligned}
^* &= \sqrt{\frac{\tilde{}\tilde{}}{6} - \frac{\tilde{}}{2} - \frac{\tilde{}^3}{27} + \sqrt{\left(\frac{\tilde{}\tilde{}}{6} - \frac{\tilde{}}{2} - \frac{\tilde{}^3}{27}\right)^2 + \left(\frac{\tilde{}}{3} - \frac{\tilde{}^2}{9}\right)^3}} \\
&\quad + \sqrt{\frac{\tilde{}\tilde{}}{6} - \frac{\tilde{}}{2} - \frac{\tilde{}^3}{27} - \sqrt{\left(\frac{\tilde{}\tilde{}}{6} - \frac{\tilde{}}{2} - \frac{\tilde{}^3}{27}\right)^2 + \left(\frac{\tilde{}}{3} - \frac{\tilde{}^2}{9}\right)^3}}
\end{aligned}
$$

One can show $^*_m = \ ^* - \tilde{}\ 3$ 0, (0) 0, and $'(_m)$ 0 for 0 $_m \geq \ ^*_m$. Therefore, given a unique root $^*_m$ 0, it is clear that $(_m) \geq 0$ for $_m \geq \ ^*_m$; hence $_1 \leq -$ $_m$ holds, iff $_m \geq \ ^*_m$. To summarize, this equilibrium exists iff $^*_m \leq \ _m \leq \ (_p)$.

Finally, consider $\in (0\ 1)$ and $_m \in (0\ 1-\ _c)$, a class 2^R equilibrium. This equilibrium requires $_1 = -\ _m$ and $_p = \ _0$. Now $_1 = -\ _m$ solves for

$$
_m = \frac{_m +\ [\ + (1-\ _c)\ _{mp}]}{_{mp}}
$$

Note 0 ${}_m$ $1 -$ ${}_c$ requires (0) ${}_m$ $(1 - {}_c)$. Then ${}_p =$ ${}_0$ solves for

$$= \frac{({}_m + \ )({}_m + \ + \bar{}_p - {}_p)}{{}_c \ [\ {}_m + \ + {}_{mp}(\bar{}_p - {}_p) + {}_{pm} \ {}_{mp}(1 - {}_c)\ ]}$$

Imposing ${}_m$ $(1 - {}_c) = -$, 0 requires ${}_m$ $({}_p)$ and ${}_m$ $({}_p)$ if ${}_p \geq \tilde{}_p \equiv \bar{}_p - (1 - {}_c)\ {}_{mp}$. When $\tilde{}_p$ 0, ${}_m$ $({}_p)$ cannot occur.

The condition 1 requires $({}_m)$ 0, where $({}_m) = {}^2_m + \ {}_m + \ $, with

$$= \bar{}_p - {}_p + 2 \ - {}_c$$
$$= (\bar{}_p - {}_p + \ ) - {}_c \ [\ + {}_{mp}(\bar{}_p - {}_p) + {}_{pm} \ {}_{mp}(1 - {}_c)\ ]$$

One can show $({}^*_m)$ 0 where ${}^*_m$ is the solution to $'({}^*_m) = 0$. There are two cases. (1) if ${}^*_m$ 0 then one can show (0) 0, and $({}_m)$ $0 \Rightarrow$ ${}_m \geq$ $({}_p)$ where $({}_p)$ is the lower root of $({}_m)$. (2) if ${}^*_m$ 0 then (2.1) if (0) 0, $({}_m)$ $0 \Rightarrow$ ${}_m \geq$ $({}_p)$; (2.2) if (0) 0, then $({}_m)$ $0 \Rightarrow$ $({}_p) \geq$ ${}_m \geq$ $({}_p)$, where $({}_p)$ is the upper root of $({}_m) = 0$. However, since ${}_m$ $({}_p)$ and $({}_p)$ $({}_p)$, $({}_p) \geq$ ${}_m$ is not binding. So, 1 requires ${}_m \geq$ $({}_p)$. To summarize, the conditions for 0 1 are ${}_m$ $({}_p)$, ${}_m$ $({}_p)$ if ${}_p \geq \tilde{}_p$, and ${}_m \geq$ $({}_p)$. Note that $({}_p)$ and $({}_p)$ intersect at $\tilde{}_p$, with $'({}_p)$ 0, which is less than $'({}_p)$. Therefore, the binding constraints for this equilibrium are $({}_p)$ ${}_m$ $(1 - {}_c)$ and ${}_p \geq \tilde{}_p$. ■