

Community Structure and Market Outcomes: Towards a Theory of Repeated Games in Networks

Itay P. Fainmesser

Abstract

This paper suggests a framework for the analysis of repeated games in buyer-seller networks. We characterize the future values of connections and the effective discount factors that sellers use in interactions with different buyers. These values are important for the ability to cooperate and maintain trust between buyers and sellers in environments with asymmetric information and moral hazard. To sustain high links values, networks need to be balanced with respect to the degree distributions of buyers and sellers. Even so, there are limits on the number of connections in the network if cooperation and trust are to be sustained. We explore the effects of globalization and show that segregation helps to sustain cooperation; in the lack of geographic constraints, segregation along other dimensions can rise. This is consistent with labor market phenomena, as well as with more general observations as homophily and clubs. Applications include labor markets and the credit industry.

(JEL: A14, C73, D82, D85, L14)

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