Discussion: "Who Wants to be a Middleman?

Stephen Williamson
Federal Reserve Bank of St. Louis

May 2016

Disclaimer

The views expressed are mine and do not necessarily reflect official positions of the Federal Reserve Bank of St. Louis, the Federal Reserve System, or its Board of Governors.

What is a Middleman?

- Some economic agent, who is neither an ultimate producer or consumer of a good or service, but intermediates between the ultimate producers and consumers.
- Examples:
  - Art Dealers.
  - Banks.
  - Amazon.
  - Ma and Pa Grocery.
- Seems middlemen are ubiquitous, but this gets tricky.
  - Middlemen provide goods and services that are included in the national income accounts – F.I.R.E. for example.
  - Is an intermediate goods producer a middleman?

Why do we have middlemen?

- Efficient risk sharing – e.g. art dealer.
- Diversification permits more efficient production of information – e.g. banks.
- Lowers search and information costs – e.g. Amazon or Ma and Pa grocery.
- Economies of scale and scope, generally.

What do we know about the economics of middlemen?

- Financial intermediation literature (information and diversification):
  - Diamond and Dybvig (1983)
  - Diamond (1984)
  - Boyd/Prescott (1986)
- Industrial organization literature: product quality.
- Search: Rubinstein/Wolinsky.
- Nosal/Wong/Wright (NWW) works from Rubinstein/Wolinsky literature.

NWW Model

- continuum of agents: $n_c + n_p + n_m + n_n = 1$
- n_c fixed; n_p, n_m, n_n endogenous.
- occupational choice: non-consumers choose
  - producer: Produce 1 unit of x, and wait to trade with a middleman or a consumer, bearing cost γ_p.
  - middleman:
    - has 1 unit of x : bears cost γ_m and waits to trade with a consumer.
    - has 0 units of x : waits to trade with a producer.
  - non-participation.
- Exchange is always one unit of x for some quantity of divisible good y, which everyone can produce at cost $U(y)$.

Results

- Role for middlemen: can store x at lower cost.
- Baseline model: unique equilibrium:
  - no producers or middlemen (0), or
  - producers and no middlemen (1), or
  - producers and middlemen (2).
- Middlemen can be essential – permit expanded production possibilities.
- $\gamma_m < 0$ can give multiplie equilibria.

Comments

- Advantage for middlemen based on a technological advantage – in financial intermediation literature, some models give no intrinsic advantage to the middleman, which is useful.
- No role for information, as for example in Yiting Li's work, which is interesting.
- Essentiality – is this interesting? For example, suppose in equilibrium that bananas are produced. If the government bans banana production, welfare falls. Are bananas essential?
- Why this particular setup?
    - Choice to be consumer, producer, middleman, or nonactive?
    - Perfectly elastic supply of would-be producers/middlemen, as in labor search models?
    - Exchange using money and other assets would be interesting – asset exchange a substitute for middlemen?