Gaining Economies of Scale in Reputation

- Repeated games as an explanation of how hidden action overcome
  - Repeated game model assumes bilateral exchange
  - Reputation serves as a “bond”

- Problem as market broadens
  - Number of possible bilateral exchanges increases exponentially
  - Monitoring costs increase, in part because you can’t know everyone
  - Therefore, probability of fly-by-night behavior increases
Gaining Economies of Scale in Reputation

- Medieval Markets
  - Weak or non-existent state contract enforcement
  - Deals made on basis of samples, with actual delivery made later
  - Potential for legitimate disputes among honest traders

Challenge

- How to make reputation work even if 2 traders often?
  - Can you make reputation transferable within a group w/i a context where it is costly to generate info on who is unreliable? (This rather than infrequency of trade may be constraint).
  - Therefore, need to find ways to generate EOS in reputation.
Potential solutions

- Clientization (trading networks)
- Guilds (associations that set standards for the profession)
- Private adjudication
- Coalitions
- Latter 2 depend on developing economies of scale in reputation and incentives for self-monitoring of trade.

Law Merchant challenges—

- Need to create incentives to
  - Behave honestly
  - Boycott the dishonest even if this is personally costly.
  - Keep informed about those who are dishonest
  - Provide evidence against cheaters
  - Honor judges decisions.
Law Merchant

- Centralizes – Only need to go to one place to get info.
- Provides more info. than just merchant’s last trade. Synthesizes info. in easy-to-understand form—outstanding judgements.