Commitment via Third-Party Contracts in Bilateral Trade: A Three-Way Equivalence[*]

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Abstract

A buyer with private value makes a take-it-or-leave-it offer to a seller with private cost. Which trading outcomes are implementable if the seller can sign observable and binding contracts ex ante with a third party that specify transfers as a function of the price posted and whether trade occurs? We establish a *three-way equivalence*: contract-implementable outcomes coincide with those achievable if the seller commits ex ante to an observable cost-dependent price-acceptance strategy, which are outcomes implementable with direct bilateral trading mechanisms subject to ex post monotonicity of the allocation in the seller's cost, and buyer's interim incentive and participation constraints. An upstream firm that charges royalties to a seller facing a monopsonist buyer can implement ex post efficiency, but also turn a buyer monopsony into a seller monopoly.

Keywords: contracts as commitment devices, monopoly pricing, buyer power, mechanism design, vertical contracts

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