Abstract

The theory of money assumes decentralized bilateral exchange and excludes centralized multilateral exchange. However, endogenizing the exchange process is critical for understanding the conditions that support the use of money. We develop a “travelling game” to study the emergence of decentralized and centralized exchange, theoretically and experimentally. Players located on separate islands can either trade locally, or pay a cost to trade elsewhere, so decentralized and centralized markets can both emerge in equilibrium. The former minimize trade costs through monetary exchange; the latter maximizes overall surplus through non-monetary exchange. Monetary trade emerges when coordination is problematic, while centralized trade emerges otherwise. This shows that to understand the emergence of money it is important to amend standard theory such that the market structure is endogenized. (JEL: E4, E5, C9, C92)