

# Endogenous Groups and Dynamic Selection in Mechanism Design\*

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Abstract

We create a dynamic theory of endogenous risk sharing groups, with good internal information, and their coexistence with relative performance, individualistic regimes, which are informationally more opaque. Inequality and organizational form are determined simultaneously. Numerical techniques and succinct re-formulations of mechanism design problems with suitable choice of promised utilities allow the computation of a stochastic steady state and its transitions. Regions of low inequality and moderate to high wealth (utility promises) produce the relative performance regime, while regions of high inequality and low wealth produce the risk sharing group regime. If there is a cost to prevent coalitions, risk sharing groups emerge at high wealth levels also. Transition from the relative performance regime to the group regime tend to occur when rewards to observed outputs exacerbate inequality, while transitions from the group regime to the relative performance regime tend to come with a decrease in utility promises. Some regions of inequality and wealth deliver long term persistence of organization form and inequality, while other regions deliver high levels of volatility. JEL Classification Numbers: D23,D71,D85,O17. Keywords: Risk sharing, incentives, mechanism design, relative performance, networks.