

Online and Matching-Based Market Design

The rich, multi-faceted, and multi-disciplinary field of matching-based market design is active and important owing to its highly successful applications, with economic and sociological impact. Its home is economics but with intimate connections to algorithm design and operations research. With chapters contributed by over 50 top researchers from all three disciplines, this volume is unique in its breadth and depth while still giving a cohesive and unified picture of the field, suitable for the uninitiated as well as the expert. It explains the dominant ideas from computer science and economics underlying the most important results on market design and introduces the main algorithmic questions and combinatorial structures. Methodologies and applications from both the pre-Internet and post-Internet eras are covered in detail. Key chapters discuss the basic notions of efficiency, fairness, and incentives and the way in which market design seeks solutions guided by normative criteria borrowed from social choice theory.

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Edited by Federico Echenique , Nicole Immorlica , Vijay V. Vazirani , Foreword by Alvin E. Roth

Frontmatter

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The cover image is meant to be a caricature of the housing market of Shapley and Shubik, appearing in Chapter 3. The picture portrays a comparison of the value of a house to that of a rock. In this case, the rock wins!

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Contents

<i>List of Contributors</i>	<i>page xiii</i>
<i>Foreword</i>	xvii
<i>Preface</i>	xxi

PART ONE FOUNDATIONS OF MARKET DESIGN

1 Two-Sided Markets: Stable Matching	3
<i>Federico Echenique, Nicole Immorlica, and Vijay V. Vazirani</i>	
1.1 Introduction	3
1.2 The Gale–Shapley Deferred Acceptance Algorithm	4
1.3 Incentive Compatibility	13
1.4 The Lattice of Stable Matchings	18
1.5 Linear Programming Formulation	29
1.6 Exercises	31
1.7 Bibliographic Notes	35
References	35
2 One-Sided Matching Markets	37
<i>Federico Echenique, Nicole Immorlica, and Vijay V. Vazirani</i>	
2.1 Introduction	37
2.2 Preliminaries	38
2.3 Random Priority and Probabilistic Serial: Ordinal, No Endowments	39
2.4 Top Trading Cycle: Ordinal, Endowments	44
2.5 Hylland–Zeckhauser: Cardinal, No Endowments	46
2.6 ϵ -Approximate ADHZ: Cardinal, Endowments	48
2.7 Online Bipartite Matching	50
2.8 Exercises	62
2.9 Bibliographic Notes	64
References	64
3 Matching Markets with Transfers and Salaries	66
<i>Federico Echenique, Nicole Immorlica, and Vijay V. Vazirani</i>	
3.1 Introduction	66

CONTENTS

3.2	The Core Studied in a Paradigmatic Setting	67
3.3	Approximate Core for the General Graph Matching Game	76
3.4	Many-to-One Matching With Salaries	82
3.5	Matching with Contracts	85
3.6	Exercises	86
3.7	Bibliographic Notes	88
	References	88
4	Objectives	90
	<i>Federico Echenique, Nicole Immorlica, and Vijay V. Vazirani</i>	
4.1	Introduction	90
4.2	Preliminaries: Individual Choice	90
4.3	A General Model of Social Choice	92
4.4	Normative Desiderata	94
4.5	Preference Aggregation	95
4.6	Pareto Optimality and Weighted Utilitarianism	98
4.7	Partial Equilibrium Analysis and Quasilinear Utility	99
4.8	Incentives	101
4.9	Bibliographical Notes	105
	References	105

PART TWO APPLICATIONS (MODERN AND TRADITIONAL)

5	Applications of Online Matching	109
	<i>Zhiyi Huang and Thorben Tröbst</i>	
5.1	Introduction	109
5.2	Models for Online Advertising	109
5.3	Arrival Models for Other Applications	120
5.4	Exercises	127
5.5	Bibliographic Notes	128
	References	128
6	Online Matching in Advertisement Auctions	130
	<i>Nikhil R. Devanur and Aranyak Mehta</i>	
6.1	Introduction	130
6.2	The AdWords Problem	132
6.3	A Family of Algorithms	133
6.4	Adversarial Model	135
6.5	Stochastic Models	137
6.6	Packing Mixed Integer Linear Programs	143
6.7	Autobidding: A Decentralized Approach to Matching	144
6.8	The Design of Sponsored Search Auctions	149
6.9	Bibliographic Notes	152
	References	153

CONTENTS

7	Spectrum Auctions from the Perspective of Matching	155
	<i>Paul Milgrom and Andrew Vogt</i>	
7.1	Introduction	155
7.2	Spectrum Auction Algorithms	157
7.3	Bidder Incentives and Regulator Objectives	161
7.4	Substitutes and Complements	163
7.5	Descending Clock Auctions	166
7.6	Conclusion	177
7.7	Bibliographic Notes	177
	References	178
8	School Choice	180
	<i>Atila Abdulkadiroğlu and Aram Grigoryan</i>	
8.1	Introduction	180
8.2	School Choice Problem	181
8.3	School Choice Problem with Indifferences	186
8.4	Controlled School Choice Problem	192
8.5	Exercises	198
8.6	Bibliographic Notes	199
	References	199
9	Kidney Exchange	201
	<i>Itai Ashlagi</i>	
9.1	Introduction	201
9.2	Preliminaries: The Exchange Pool	202
9.3	Individually Rational Mechanisms	202
9.4	Market Thickness in Static Exchange Pools	204
9.5	Optimization	206
9.6	Collaboration and Free Riding	207
9.7	Dynamic Matching	210
9.8	Bibliographic Notes	214
	References	214

PART THREE THEORY

10	Normative Properties for Object Allocation Problems: Characterizations and Trade-Offs	219
	<i>Lars Ehlers Bettina Klaus</i>	
10.1	Introduction	219
10.2	The Basic Model	220
10.3	Top Trading Cycles Rules	221
10.4	Serial Dictatorship Rules	224
10.5	Endowment Inheritance Rules	226
10.6	Deferred Acceptance Rules	230
10.7	Relationships Between Classes of Rules	232
10.8	Exercises	234

CONTENTS

10.9 Bibliographic Notes	235
References	236
11 Choice and Market Design	238
<i>Samson Alva and Battal Doğan</i>	
11.1 Introduction	238
11.2 Modeling Choice Behavior	239
11.3 Revealed Preference and Choice Behavior	244
11.4 Combinatorial Choice Behavior	248
11.5 Path-Independent Choice	249
11.6 Combinatorial Choice from Priorities and Capacities	253
11.7 Choice and Deferred Acceptance	257
11.8 Exercises	260
11.9 Bibliographic Notes	262
References	262
12 Combinatorics of Stable Matchings	264
<i>Tamás Fleiner</i>	
12.1 Introduction	264
12.2 The Edge Removal Lemma	265
12.3 Bipartite Stable Matchings	270
12.4 Applications	273
12.5 Stable <i>b</i> -Matchings	277
12.6 Exercises	279
12.7 Bibliographic Notes	280
References	282
13 Algorithmics of Matching Markets	283
<i>Jiehua Chen and David Manlove</i>	
13.1 Introduction	283
13.2 Preliminaries	285
13.3 Stable Marriage with Ties and Incomplete Lists	287
13.4 Stable Roommates without Ties: Two Parameterized Algorithms	294
13.5 Selected Open Questions	299
13.6 Bibliographic Notes	300
References	301
14 Generalized Matching: Contracts and Networks	303
<i>John William Hatfield, Ravi Jagadeesan, Scott Duke Kominers, Alexandru Nichifor, Michael Ostrovsky, Alexander Teytelboym, and Alexander Westkamp</i>	
14.1 Introduction	303
14.2 The Framework	304
14.3 Two-Sided Matching with Contracts	305
14.4 Supply Chains and Trading Networks	313
14.5 Transfers	317
14.6 Exercises	319
References	319

CONTENTS

15 Complementarities and Externalities	323
<i>Thành Nguyen and Rakesh Vohra</i>	
15.1 Introduction	323
15.2 Existence of Stable Matching, Revisited	324
15.3 Couples Matching	329
15.4 Complementarity via Constraints	332
15.5 Other Methods	338
15.6 Open Questions	339
15.7 Bibliographic Notes	340
References	340
 16 Large Matching Markets	 343
<i>Jacob D. Leshno</i>	
16.1 Random Matching Markets and the Puzzle for the Proposing Side	344
16.2 Continuum Matching Markets	351
16.3 Exercises	357
16.4 Bibliographic Notes	358
References	359
 17 Pseudomarkets	 361
<i>Marek Pycia</i>	
17.1 Introduction	361
17.2 Preliminaries: Walrasian Equilibria in Discrete Settings	361
17.3 Eliciting Agents’ Utilities	365
17.4 Efficiency	369
17.5 Fairness, Multiple-Unit Demand, Priorities, and Constraints	375
17.6 Exercises	377
17.7 Bibliographic Notes	378
References	379
 18 Dynamic Matching	 381
<i>Mariagiovanna Baccara and Leeat Yariv</i>	
18.1 Introduction	381
18.2 Dynamic One-Sided Allocations	382
18.3 Dynamic Two-Sided Matching	387
18.4 Bibliographic Notes	399
References	400
 19 Matching with Search Frictions	 402
<i>Hector Chade and Philipp Kircher</i>	
19.1 Introduction	402
19.2 Benchmark: Frictionless Case	402
19.3 Search Frictions: Some Modeling Choices	405
19.4 Directed Search	406
19.5 Random Search	413

CONTENTS

19.6	Bibliographical Notes	424
	References	425
20	Unraveling	428
	<i>Guillaume Haeringer and Hanna Halaburda</i>	
20.1	Introduction	428
20.2	Stable Mechanisms Are Not Enough to Prevent Unraveling	430
20.3	Market Timing and the Nature of Offers	432
20.4	Uncertainty as a Source of Unraveling	434
20.5	Structural Conditions	441
20.6	Information Disclosure and Unraveling	443
20.7	Bibliographic Notes	446
	References	446
21	Investment in Matching Markets	448
	<i>Matthew Elliott and Eduard Talamàs</i>	
21.1	Introduction	448
21.2	Motivating Example	449
21.3	Model	449
21.4	Private Investment Incentives	451
21.5	Efficient Investments	455
21.6	Proofs of the Main Results	458
21.7	Discussion	461
21.8	Final Remarks	463
21.9	Exercises	463
	References	465
22	Signaling in Two-Sided Matching Markets	467
	<i>Soohyung Lee</i>	
22.1	Introduction	467
22.2	Setting	467
22.3	Lessons from Theoretical Analyses	472
22.4	Signaling in Practice	476
22.5	Concluding Remarks	479
22.6	Bibliographic Notes	480
	References	481
23	Two-Sided Markets and Matching Design	484
	<i>Renato Gomes and Alessandro Pavan</i>	
23.1	Introduction	484
23.2	General Setup	484
23.3	Pricing in Two-Sided Markets	486
23.4	Unknown Preference Distribution	492
23.5	Matching Design	496
23.6	Conclusions	506
23.7	Bibliographical Notes	507
	References	507

CONTENTS

PART FOUR EMPIRICS

24 Matching Market Experiments	511
<i>Yan Chen</i>	
24.1 Introduction	511
24.2 Laboratory Experiments	512
24.3 Lab-in-the-Field Experiments	521
24.4 Field Experiments	523
24.5 Bibliographic Notes	527
References	527
25 Empirical Models of Non-Transferable Utility Matching	530
<i>Nikhil Agarwal and Paulo Somaini</i>	
25.1 Introduction	530
25.2 Empirical Model	531
25.3 Analysis Using Final Matches and Stability	534
25.4 Analysis Using Reported Preferences	543
25.5 Applications, Extensions, and Open Questions	546
25.6 Conclusion	548
References	549
26 Structural Estimation of Matching Markets with Transferable Utility	552
<i>Alfred Galichon and Bernard Salanié</i>	
26.1 Matching with Unobserved Heterogeneity	553
26.2 Identification	558
26.3 Estimation	560
26.4 Computation	565
26.5 Other Implementation Issues	566
26.6 Bibliographic Notes	567
References	570

PART FIVE RELATED TOPICS

27 New Solution Concepts	575
<i>Shengwu Li and Irene Lo</i>	
27.1 Introduction	575
27.2 Obvious Strategy-Proofness	576
27.3 Stability under Incomplete Information	582
27.4 Exercises	588
27.5 Bibliographic Notes	589
References	589
28 Machine Learning for Matching Markets	591
<i>Zhe Feng, David C. Parkes, and Sai Srivatsa Ravindranath</i>	

CONTENTS

28.1	Introduction	591
28.2	Artificial Neural Networks	591
28.3	Optimal Auction Design	593
28.4	Two-Sided Matching	600
28.5	Discussion	610
28.6	Bibliographic Notes	611
	References	612
29	Contract Theory	614
	<i>Gabriel Carroll</i>	
29.1	Introduction	614
29.2	Hidden-Action Models	614
29.3	Hidden-Information Models	626
29.4	Exercises	632
29.5	Bibliographic Notes	634
	References	634
30	Secretaries, Prophets, and Applications to Matching	635
	<i>Michal Feldman and Brendan Lucier</i>	
30.1	Introduction to Sequential Online Decision-Making	635
30.2	The Secretary Problem	636
30.3	The Prophet Inequality	640
30.4	Application: Online Weighted Matching	642
30.5	Exercises	652
30.6	Bibliographic Notes	653
	References	654
31	Exploration and Persuasion	655
	<i>Aleksandrs Slivkins</i>	
31.1	Motivation and Problem Formulation	656
31.2	Connection to Multi-Armed Bandits	658
31.3	Connection with Bayesian Persuasion	662
31.4	How Much Information to Reveal?	665
31.5	“Hidden Persuasion” for the General Case	667
31.6	Incentivized Exploration via “Hidden Persuasion”	670
31.7	A Necessary and Sufficient Assumption on the Prior	671
31.8	Bibliographic Notes	672
	References	674
32	Fairness in Prediction and Allocation	676
	<i>Jamie Morgenstern and Aaron Roth</i>	
32.1	Introduction	676
32.2	The Need to Choose	681
32.3	Fairness in a Dynamic Model	683
32.4	Preserving Information Before Decisions	688
32.5	Bibliographic Notes	691
	References	691
	<i>Index</i>	694

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Foreword

This volume is a tribute to the interdisciplinarity (if that’s a word) of matching markets and market design. It is also an invitation to pursue the many important open questions concerning theory, computation, and practical market design that are surveyed here from the perspectives of economics, computer science, and operations research.

Two of the founding papers of this literature are due to Gale and Shapley [3] and Shapley and Scarf [11]. Both demonstrated algorithms, for two crisply defined discrete models, that showed constructively that the core of the game – the set of outcomes that can’t be disrupted by dissatisfied coalitions – is non-empty. That is, both papers demonstrated algorithms that could use information about the preferences of participants to identify outcomes with desirable efficiency and stability properties.

Gale and Shapley introduced what has become a canonical model of two-sided matching, which they called the marriage problem, involving two disjoint sets of players (e.g., “men” and “women”), each of whom has preferences over players on the other side. (They also sketched a many-to-one generalization that they called the college admissions problem.) An outcome of the game is a matching of men and women. They defined stable matchings as those that no man – woman pair not matched to each other, and no unhappily matched individual, would prefer to disrupt and introduced the deferred acceptance algorithm, which finds a stable matching with respect to any preferences. Under the rules that any willing pair of players from opposite sides may be matched to one another if and only if they both agree, the set of stable matchings is the core of the resulting game. But the set of stable matchings has proved of great interest even in models in which it differs from the core. And the deferred acceptance algorithm has sparked a literature of its own, not least in computer science, where it became well known following Donald Knuth’s 1976 monograph in French, *Mariages Stables*.¹

Shapley and Scarf introduced a model in which each agent initially possesses a single unit of an indivisible good, which they called a house. Agents have preferences over all the houses, which can be traded. But no money can be used: trades have to be house swaps, among cycles of any length. They introduced the top trading cycles algorithm (which they attributed to David Gale) and showed that, for any preferences over houses, it produces an allocation in the core of the game, i.e., one that no coalition can improve upon by trading among its own members. This is a

¹ For the English translation, see [5].

FOREWORD

“one-sided” model: any player can trade with any other (unlike the case of the two-sided marriage model). Another way in which this and other models are one-sided rather than two-sided is that players (who have preferences, and for whom we have welfare concerns) are matched to objects, not to other players.

While both of these foundational papers were boundary-busting in how they combined game theory with algorithms, they both started from the point of view of cooperative game theory. The object of cooperative game theory (which was thought of as the study of a class of games in which players could reach binding agreements) was to identify desirable or likely outcomes of the games studied, whose rules were specified in terms of what coalitions could achieve by agreement, not in terms of what specific actions individual players could take. In contrast, non-cooperative game theory was thought of as studying games in which no binding agreements could be reached, and rules were specified in terms of the strategies that individuals could independently employ.

It seemed natural to think of Gale – Shapley and Shapley – Scarf as suggesting the designs of centralized clearinghouses, which would use information about the market to suggest market outcomes to participants. But while data on participants and resources could be observed and incorporated into the design of a clearinghouse, preferences are the private information of individuals. If we were interested in actually designing a centralized clearinghouse built around the deferred acceptance algorithm or top trading cycles, how would we obtain the preferences needed as inputs? In Roth [6], [7] I began to study when it would be safe for participants who were asked to state their preferences to state them truthfully. In game-theoretic terms, I was studying what was then thought of as part of non-cooperative game theory, namely when and for whom it could be made a *dominant strategy* to state preferences truthfully. I found that the top trading cycles algorithm makes it a dominant strategy to state preferences truthfully in the Shapley and Scarf model, but that no mechanism that always produces stable matchings can make the truthful revelation of preferences a dominant strategy for all players in the marriage model. However, it is possible to make it a dominant strategy for one side of the marriage market to state true preferences, and this has in some applications been sufficient, particularly in light of many subsequent results on the difficulty and low prevalence of profitable opportunities for agents on the other side to misrepresent their preferences in naturally occurring markets.²

These approaches showed that matching markets can be thought of both as cooperative games and as non-cooperative games, and today we no longer think of those two kinds of game theory as necessarily studying different games. Rather, coalitional models from cooperative game theory and strategic models from non-cooperative game theory answer different kinds of market design questions about a given market (see Roth and Wilson [10]). For example, the papers Roth [8] and Roth and Peranson [10] each studied the clearinghouse for new American doctors from the point of view of when stable matchings exist, and when truthful preferences can be safely elicited.

In the years since those beginnings, market design has continued to break boundaries, including those between theory, computation, and application. Market design has become an engineering discipline, in which game theory, computation,

² Dubins and Freedman [2] and Bergstrom and Manning [1] independently investigated closely related questions about the marriage model.

FOREWORD

optimization, observation, and a healthy dose of trial and error combine to create new designs, which have had some notable practical successes in being implemented and maintained.

This volume opens up a window on much that has been accomplished so far. For readers new to the field, it provides an easy entryway, and the introductory essays by the editors provide helpful orientation. And (if my own experience is any indication) even grizzled veterans will find much to learn here, in the chapters on theory, on empirics and design, and on new boundaries to cross. This is a volume to read and study, and to let yourself be invited and recruited into the theory of matching and the practice of market design.

Alvin E. Roth

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Preface

The topic of this book is the rich, multi-faceted, and multi-disciplinary field of matching-based market design. Although the home discipline of this field is economics, it has been intimately connected to the discipline of algorithm design right from its birth³ and also shares boundaries with operations research. With chapters contributed by over 50 top researchers, from all three disciplines, this volume is unique in its breadth and depth of coverage while still retaining the feel of a cohesive, unified textbook.

The importance of this field arises from its highly successful applications, having economic as well as sociological impact. From the viewpoint of applications and algorithmic methodology, the field consists of two distinct eras – pre-Internet and post-Internet. Methodologies and applications from both eras are covered in detail in this book.

The book covers the dominant ideas from computer science and economics that underlie the most important results on market design. It introduces readers to the main algorithmic questions raised by matching markets, as well as to the key combinatorial structures that underlie such questions. It discusses the basic notions of efficiency, fairness, and incentives and the way in which market design seeks solutions that are guided by normative criteria borrowed from social choice theory. Because of its broad sweep of introductory as well as advanced topics, it will be valuable for the uninitiated as well as the expert.

The text is suitable for use in a wide variety of courses across several disciplines, as will be described next. A basic semester-long course on the topics of the book, suitable for upper-level undergraduates and beginning graduate students, would cover the four chapters of Part One, most of the chapters from Part Two, and a selection of the rest, based on the instructor's preferences. For a graduate course in economics, the book offers cutting-edge results on the most important areas of research on these topics today, e.g., school choice, the AdWords and other online marketplaces, the organ donation market, large markets, and machine learning and pseudo-markets. A course on the economic theories of market design would concentrate on Parts One and Three, against a backdrop of other relevant topics. Readers interested in experimental economics, applied economics, or operations research will find relevant material in Parts Two and Four, and Part Five will appeal to those interested in new directions and advanced topics.

³ The main result of the 1962 paper of Gale and Shapley, which initiated this field, was an *efficient algorithm* for the stable matching problem, obtained three years before polynomial time solvability was formally defined!

PREFACE

Because of the groundswell of fundamental algorithmic ideas, presented from first principles, this book is also suitable for use as a supplementary text in basic undergraduate and graduate courses on algorithm design. The first three chapters of Part One are particularly suitable for this.

Multiple thanks are due. First, to the chapter authors for producing very high quality chapters in a timely manner. Second, to Simons Institute for running a program on the same topic as the title of the book, in Fall 2019; it provided a scintillating environment in which the detailed structure of this book evolved. Third, to Lauren Cowles for her expert advice throughout the two years in which this book took shape.

We hope this book will contribute to the rapid growth of this field, not only as a pedagogic tool but also via the large number of open problems and issues discussed in the more advanced chapters. It is our intention that it will be in active use for several decades to come.

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