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Do Competing Specialists and Preferencing Dealers Affect Market Quality?

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Abstract

We empirically demonstrate that the opportunities the Boston Stock Exchange and the Cincinnati Stock Exchange offer members to take the other side of their customers' orders through affiliated market makers (to internalize orders) have little short-run effect on posted or effective bid-ask spreads. This is true despite substantial movement of order flow away from the New York Stock Exchange when trading under one of these regional stock exchange programs begins. These results contrast with the adverse effects of market fragmentation and internalization predicted by some theoretical market microstructure analyses and the popular financial press.

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