

So you want to know  
about...

# Non-zero-sum Game Theory, Auctions and Negotiation

...Well what's it  
worth to you, eh?

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# A Non-Zero Sum Game Prisoner's Dilemma

		B Cooperates	B Defects
A Cooperates		<b>-1 , -1</b> A's payoff      B's payoff	<b>-9 , 0</b> A's payoff      B's payoff
A Defects		<b>0 , -9</b> A's payoff      B's payoff	<b>-6 , -6</b> A's payoff      B's payoff

**Non-Zero-Sum** means there's at least one outcome in which  $(A's \text{ PAYOFF} + B's \text{ PAYOFF}) \neq 0$

# Normal Form Representation of a Non-Zero-Sum Game with $n$ players

Is a set of  $n$  strategy spaces  $S_1, S_2 \dots S_n$   
where  $S_i$  = The set of strategies available to player  $i$

And  $n$  payoff functions

$$u_1, u_2 \dots u_n$$

where

$$u_i : S_1 \times S_2 \times \dots \times S_n \rightarrow \mathcal{R}$$

is a function that takes a combination of strategies (one for each player) and returns the payoff for player  $i$

		PLAYER B (2)	
		C	D
PLAYER A (1)	C	<b>-1 , -1</b>	<b>-9 , 0</b>
	D	<b>0 , -9</b>	<b>-6 , -6</b>

$$n = 2$$

$$S_1 = \{C,D\}$$

$$S_2 = \{C,D\}$$

$$u_1 (C,C) = -1$$

$$u_2 (C,C) = -1$$

$$u_1 (C,D) = -9$$

$$u_2 (C,D) = 0$$

$$u_1 (D,C) = 0$$

$$u_2 (D,C) = -9$$

$$u_1 (D,D) = -6$$

$$u_2 (D,D) = -6$$

what would you do if you were Player A ??

# Strict Domination



IT'S A COLD, CRUEL  
WORLD. GET OVER IT.



PLAYER B

Assuming B plays "C", what  
should I do ?

Assuming B plays "D", what  
oh what should I do ?

		C	D
PLAYER A	C	-1 , -1	-9 , 0
	D	0 , -9	-6 , -6

If one of a player's strategies is  
never the right thing to do, no  
matter what the opponents do, then  
it is **Strictly Dominated**

# “Understanding” a Game

Fundamental assumption of game theory:

**Get Rid of the Strictly Dominated strategies.  
They Won't Happen.**

	C	D
C	<b>-1 , -1</b>	<b>-9 , 0</b>
D	<b>0 , -9</b>	<b>-6 , -6</b>

In some cases (e.g. prisoner's dilemma) this means, if players are “rational” we can predict the outcome of the game.

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C	D	-1 , -1	-9 , 0	→	D
		0 , -9	-6 , -6		

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→

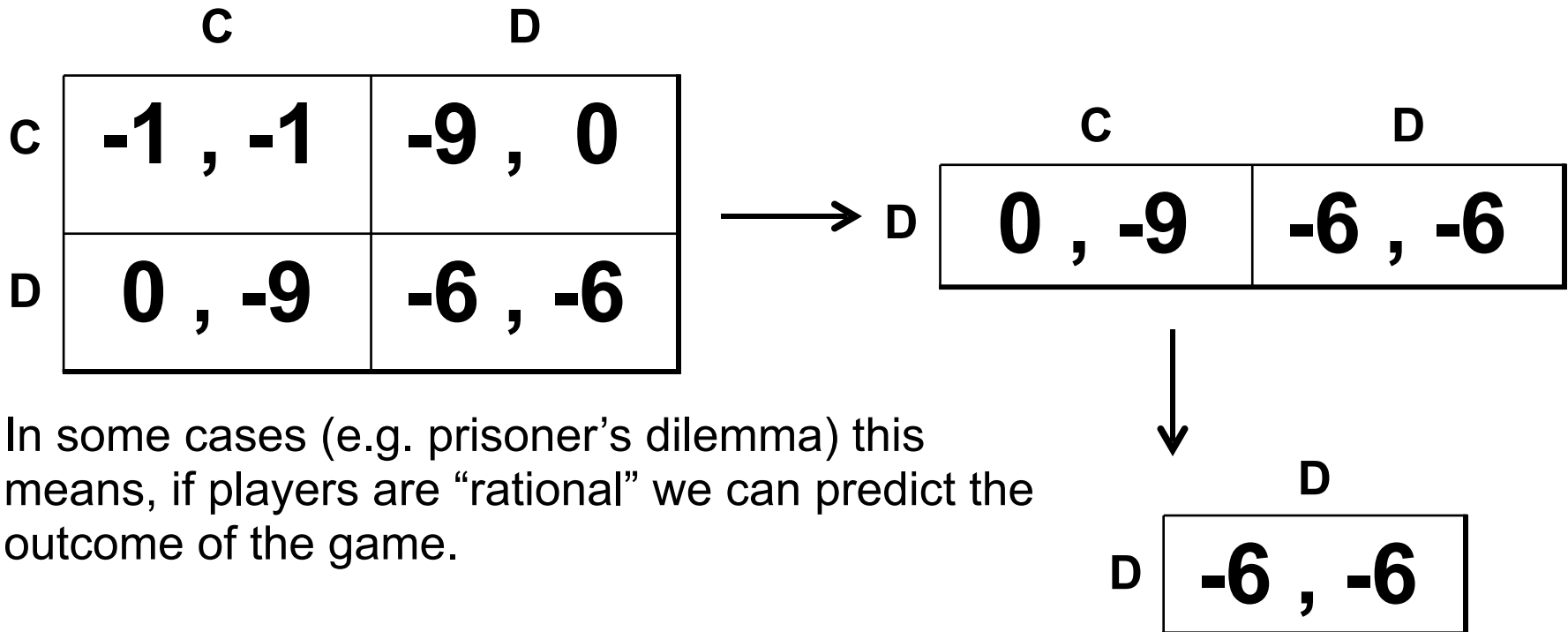
	C	D
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In some cases (e.g. prisoner's dilemma) this means, if players are “rational” we can predict the outcome of the game.

# Strict Domination Removal Example

		Player B			
		I	II	III	IV
Player A	I	3 , 1	4 , 1	5 , 9	2 , 6
	II	5 , 3	5 , 8	9 , 7	9 , 3
	III	2 , 3	8 , 4	6 , 2	6 , 3
	IV	3 , 8	3 , 1	2 , 3	4 , 5

So is strict domination the best tool for predicting what will transpire in a game ?

# Strict Domination doesn't capture the whole picture

	I	II	III
I	0 , 4	4 , 0	5 , 3
II	4 , 0	0 , 4	5 , 3
III	3 , 5	3 , 5	6 , 6

What strict domination eliminations can we do?

What would you predict the players of this game would do?

# Nash Equilibria

$$S_1^* \in S_1, S_2^* \in S_2, \boxed{?} S_n^* \in S_n$$

are a NASH EQUILIBRIUM iff

$$\forall i \quad S_i^* = \arg \max_{S_i} u_i(S_1^*, S_2^*, \boxed{?} S_{i-1}^*, S_i, S_{i+1}^*, \boxed{?} S_n^*)$$

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	I <sub>b</sub>	II <sub>b</sub>	III <sub>b</sub>
I <sub>a</sub>	0 4	4 0	5 3
II <sub>a</sub>	4 0	0 4	5 3
III <sub>a</sub>	3 5	3 5	6 6

(III<sub>a</sub>, III<sub>b</sub>) is a N.E. because

$$u_1(\text{III}_a, \text{III}_b) = \max \begin{bmatrix} u_1(\text{I}_a, \text{III}_b) \\ u_1(\text{II}_a, \text{III}_b) \\ u_1(\text{III}_a, \text{III}_b) \end{bmatrix}$$

$$\text{AND } u_2(\text{III}_a, \text{III}_b) = \max \begin{bmatrix} u_2(\text{III}_a, \text{I}_b) \\ u_2(\text{III}_a, \text{II}_b) \\ u_3(\text{III}_a, \text{III}_b) \end{bmatrix}$$

- If  $(S_1^*, S_2^*)$  is an N.E. then player 1 won't want to change their play given player 2 is doing  $S_2^*$
- If  $(S_1^*, S_2^*)$  is an N.E. then player 2 won't want to change their play given player 1 is doing  $S_1^*$





Find the NEs:

-1	-1	-9	0
0	-9	-6	-6

0	4	4	0	•	3
•	0	0	4	•	3
3	5	•	5	6	6

- Is there always at least one NE ?
- Can there be more than one NE ?

# Example with no NEs among the pure strategies:

	$S_1$	$S_2$
$S_1$		
$S_2$		



# Example with no NEs among the pure strategies:

	$S_1$	$S_2$								
$S_1$	<table><tr><td>0</td><td>1</td></tr><tr><td><u>        </u></td><td><u>        </u></td></tr></table>	0	1	<u>        </u>	<u>        </u>	<table><tr><td>1</td><td>0</td></tr><tr><td><u>        </u></td><td><u>        </u></td></tr></table>	1	0	<u>        </u>	<u>        </u>
0	1									
<u>        </u>	<u>        </u>									
1	0									
<u>        </u>	<u>        </u>									
$S_2$	<table><tr><td>1</td><td>0</td></tr><tr><td><u>        </u></td><td><u>        </u></td></tr></table>	1	0	<u>        </u>	<u>        </u>	<table><tr><td>0</td><td>1</td></tr><tr><td><u>        </u></td><td><u>        </u></td></tr></table>	0	1	<u>        </u>	<u>        </u>
1	0									
<u>        </u>	<u>        </u>									
0	1									
<u>        </u>	<u>        </u>									

## 2-player mixed strategy Nash Equilibrium

The pair of mixed strategies  $(M_A, M_B)$  are a **Nash Equilibrium** iff

- $M_A$  is player A's best mixed strategy response to  $M_B$

AND

- $M_B$  is player B's best mixed strategy response to  $M_A$

# Fundamental Theorems

- In the  $n$ -player pure strategy game  $G = \{S_1, S_2, \dots, S_n; u_1, u_2, \dots, u_n\}$ , if iterated elimination of strictly dominated strategies eliminates all but the strategies  $(S_1^*, S_2^*, \dots, S_n^*)$  then these strategies are the unique NE of the game
- Any NE will survive iterated elimination of strictly dominated strategies
- [Nash, 1950] If  $n$  is finite and  $S_i$  is finite  $\forall i$ , then there exists at least one NE (possibly involving mixed strategies)

# The “What to do in Pittsburgh on a Saturday afternoon” game

Pat enjoys football

Chris enjoys hockey

Pat and Chris are friends: they enjoy spending time together

		Chris	
		H	F
Pat	H	1 2	0 0
	F	0 0	2 1

- Two Nash Equilibria.
- How useful is Game Theory in this case??
- Why this example is troubling...

# INTERMISSION

(Why) are Nash Equilibria useful for A.I. researchers?

Will our algorithms ever need to play...

Prisoner's Dilemma?

Saturday Afternoon?

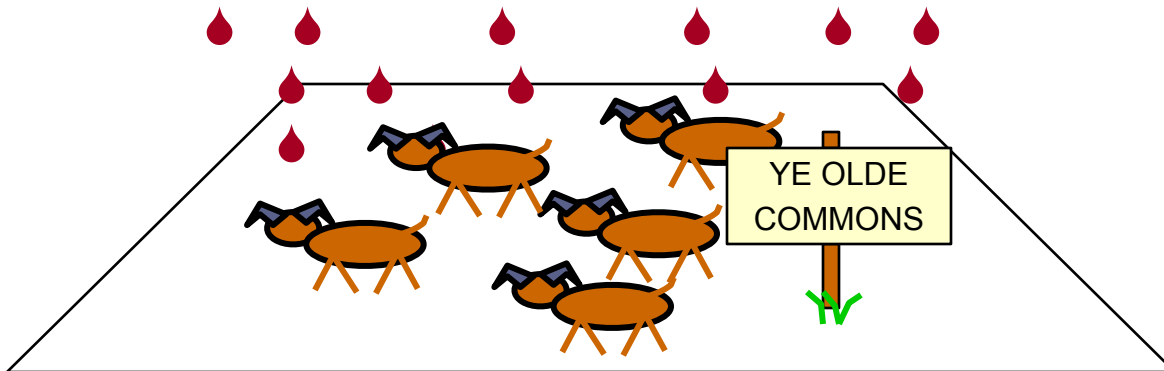
# Nash Equilibria Being Useful



## THE TRAGEDY OF THE

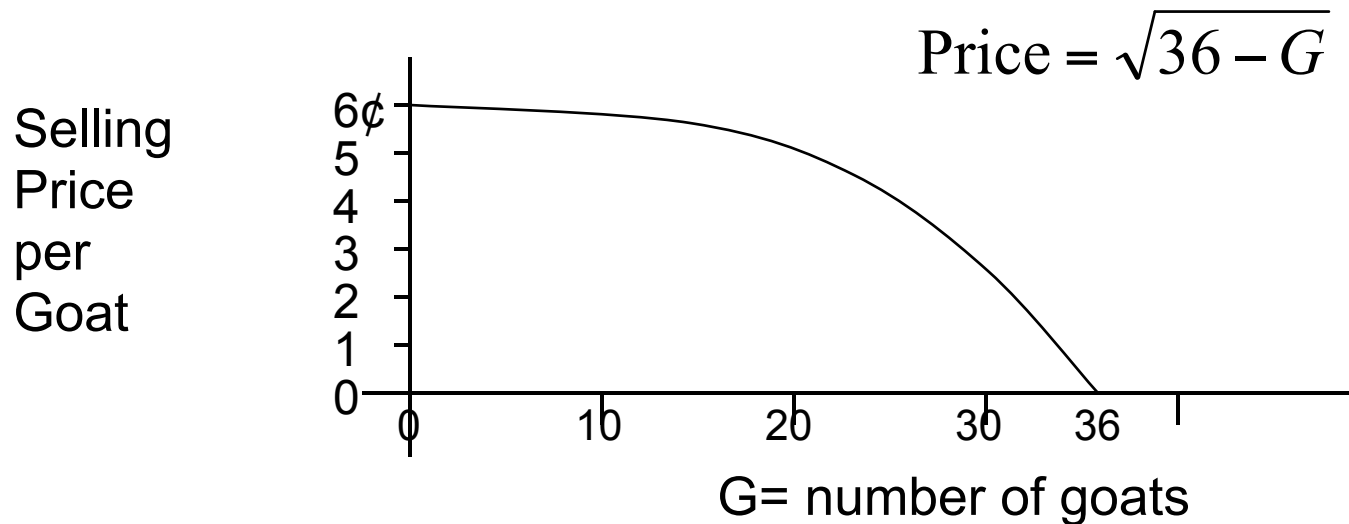


# Commons



- You graze goats on the commons to eventually fatten up and sell
- The more goats you graze the less well fed they are
- And so the less money you get when you sell them

# Commons Facts



How many goats would one rational farmer choose to graze?

What would the farmer earn?

What about a group of  $n$  individual farmers?

Answering this...

...is good practice for answering this

$n$  farmers

$i$ 'th farmer has an infinite space of strategies

$$g_i \in [0, 36]$$

An outcome of

$$(g_1, g_2, g_3, \dots, g_n)$$

will pay how much to the  $i$ 'th farmer?



$n$  farmers

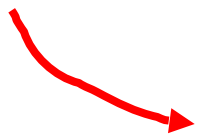
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$$g_i \times \sqrt{36 - \sum_{j=1}^n g_j}$$

Let's **Assume** a pure **Nash Equilibrium** exists.

Call it  $(g_1^*, g_2^*, \boxed{?} g_n^*)$

What can we say about  $g_1^*$  ?

$$g_i^* = \arg \max_{g_i} \left[ \begin{array}{l} \text{Payoff to farmer i, assuming} \\ \text{the other players play} \\ (g_1^*, g_2^*, \boxed{?} g_{i-1}^*, g_{i+1}^*, \boxed{?} g_n^*) \end{array} \right]$$

For Notational Convenience,

write  $G_{-i}^* = \sum_{j \neq i} g_j^*$

THEN

$$g_i^* = \arg \max_{g_i} \left[ \right]$$



What?

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THEN

$$g_i^* = \arg \max_{g_i} \left[ g_i \sqrt{36 - g_i - G_{-i}^*} \right]$$

Let's **Assume** a pure **Nash Equilibrium** exists.

Call it

$$(g_1^*, g_2^*, \dots, g_n^*)$$

What can we say about

$$g_i^* = \arg \max_{g_i} \left[ \text{Payoff}_i(g_i, g_1^*, \dots, g_n^*) \right]$$

For Notational Convenience

$$\text{write } G_{-i}^* = \sum_{j \neq i} g_j^*$$

THEN

$$g_i^* = \arg \max_{g_i} \left[ g_i \sqrt{36 - g_i - G_{-i}^*} \right]$$

$g_i^*$  must satisfy

$$\frac{\partial}{\partial g_i} g_i^* \sqrt{36 - g_i^* - G_{-i}^*} = 0$$

therefore

$$\frac{36 - G_{-i}^* - \frac{3}{2} g_i^*}{\sqrt{36 - g_i^* - G_{-i}^*}} = 0$$

# We have $n$ linear equations in $n$ unknowns

$$g_1^* = 24 - 2/3(g_2^* + g_3^* + \cdots g_n^*)$$

$$g_2^* = 24 - 2/3(g_1^* + g_3^* + \cdots g_n^*)$$

$$g_3^* = 24 - 2/3(g_1^* + g_2^* + g_4^* \cdots g_n^*)$$

$$\vdots$$

$$g_n^* = 24 - 2/3(g_1^* + \cdots g_{n-1}^*)$$

Clearly all the  $g_i^*$ 's are the same (Proof by “it’s bloody obvious”)

Write  $g^* = g_1^* = \cdots g_n^*$

Solution to  $g^* = 24 - 2/3(n-1)g^*$  is:

$$g^* = \frac{72}{2n+1}$$

# Consequences

At the Nash Equilibrium a rational farmer grazes

$$\frac{72}{2n+1} \text{ goats.}$$

How many goats in general will be grazed? Trivial algebra gives:  $36 - \frac{36}{2n+1}$  goats total being grazed  
[as  $n \rightarrow \infty$ , #goats  $\rightarrow 36$ ]

How much profit per farmer?

$$\frac{432}{(2n+1)^{3/2}}$$

1.26¢ if  
24 farmers

How much if the farmers could all cooperate?

$$\frac{24 \cdot \sqrt{12}}{n} = \frac{83.1}{n}$$

3.46¢ if  
24 farmers

# The Tragedy

The farmers act “rationally” and earn 1.26 cents each.

But if they’d all just got together and decided “one goat each” they’d have got 3.46 cents each.

Is there a bug in Game Theory?  
in the Farmers?  
in Nash?

Would you recommend the farmers hire a police force?

# Recipe for Nash-Equilibrium-Based Analysis of Such Games

- Assume you've been given a problem where the  $i$ 'th player chooses a real number  $x_i$
- Guess the existence of a Nash equilibrium  $(x_1^*, x_2^* \cdots x_n^*)$

- Note that ,  $\forall i$ ,

$$x_i^* = \arg \max_{x_i} \left[ \begin{array}{l} \text{Payoff to player } i \text{ if player } i \\ \text{plays " } x_i \text{ " and the } j' \text{ th player} \\ \text{plays } x_j^* \text{ for } j \neq i \end{array} \right]$$

- Hack the algebra, often using “at  $x_i^*$  we have  $\frac{\partial}{\partial x_i} \text{ Payoff} = 0$ ”



# INTERMISSION

Does the Tragedy of the Commons matter to us when we're building intelligent machines?

Maybe repeated play means we can learn to cooperate??

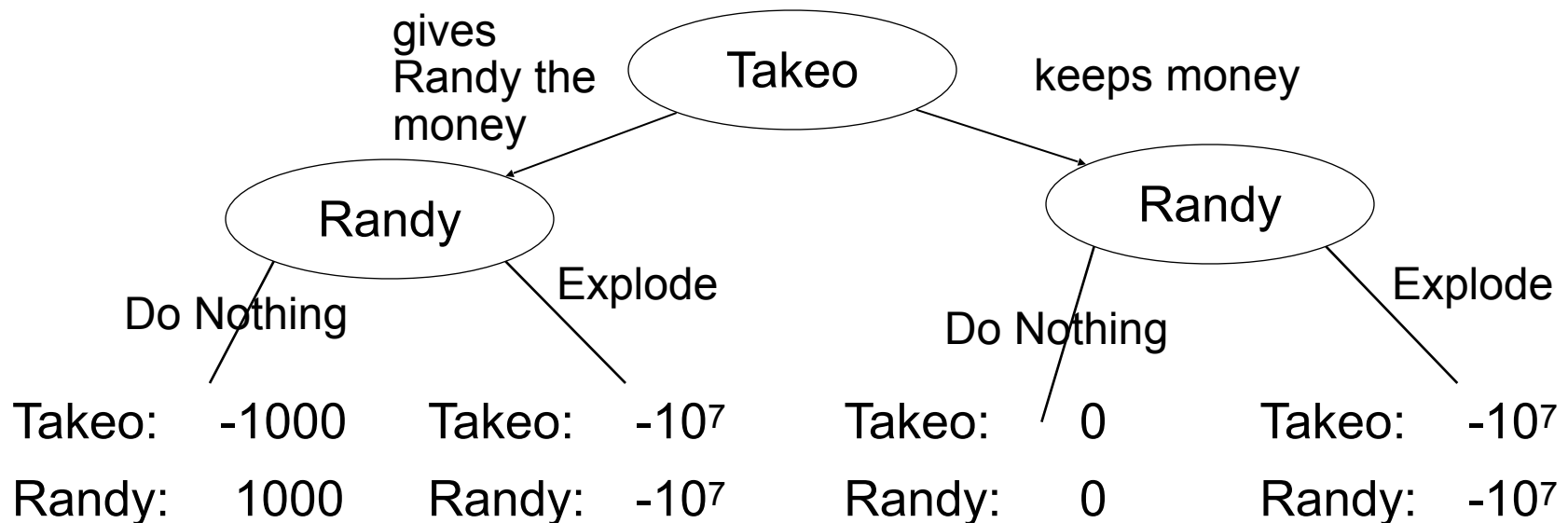
# Repeated Games with Implausible Threats

Takeo and Randy are stuck in an elevator

Takeo has a \$1000 bill

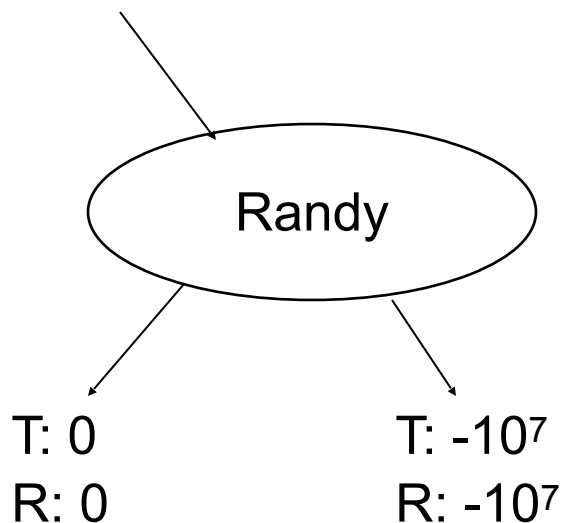
Randy has a stick of dynamite

Randy says “Give me \$1000 or I’ll blow us both up.”



**What should Takeo do?????**

Using the formalism of Repeated Games With Implausible Threats, Takeo should **Not** give the money to Randy



Takeo **Assumes Randy is Rational**

At this node, Randy will choose the left branch

### Repeated Games

Suppose you have a game which you are going to play a finite number of times.

What should you do?

# 2-Step Prisoner's Dilemma

GAME 1

		Player B	
		C	D
Player A	C	-1 , -1	-9 , 0
	D	0 , -9	-6 , -6

GAME 2  
(Played with knowledge of outcome of GAME 1)

		Player B	
		C	D
Player A	C	-1 , -1	-9 , 0
	D	0 , -9	-6 , -6

Idea 1

Player A has four pure strategies  
 C then C  
 C then D  
 D then C  
 D then D

Is Idea 1 correct?

Ditto for B

# Important Theoretical Result:

Assuming Implausible Threats, if the game  $G$  has a unique N.E.  $(s_1^*, \dots, s_n^*)$  then the new game of repeating  $G$   $T$  times, and adding payouts, has a unique N.E. of repeatedly choosing the original N.E.  $(s_1^*, \dots, s_n^*)$  in every game.

If you're about to play prisoner's dilemma 20 times, you should defect 20 times.

**DRAT** ☹️

# Intermission

Game theory has been cute so far.

But depressing.

Now let's make it really work for us.

We're going to get more real.

The notation's growing teeth.

# Bayesian Games

You are Player A in the following game. What should you do?

		Player B	
		$S_1$	$S_2$
Player A	$S_1$	3   ?	-2   ?
	$S_2$	0   ?	6   ?

**Question:** When does this situation arise?

Hockey lovers get 2 units for watching hockey, and 1 unit for watching football.

Football lovers get 2 units for watching football, and 1 unit for watching hockey.

Pat's a hockey lover.

Pat thinks Chris is probably a hockey lover also, but Pat is not sure.

		Chris	
		H	F
Pat	H	2 2	0 0
	F	0 0	1 1

With 2/3 chance

		Chris	
		H	F
Pat	H	2 1	0 0
	F	0 0	1 2

1/3 chance



In a Bayesian Game each player is given a type. All players know their own types but only a prob. dist. for their opponent's types

An  $n$ -player Bayesian Game has

a set of action spaces	$A_1 \cdots A_n$	
a set of type spaces	$T_1 \cdots T_n$	a set
of beliefs	$P_1 \cdots P_n$	a set
of payoff functions	$u_1 \cdots u_n$	

$P_{-i}(t_{-i}|t_i)$  is the prob dist of the types for the other players, given player  $i$  has type  $t_i$ .

$u_i(a_1, a_2, \dots, a_n, t_i)$  is the payout to player  $i$  if player  $j$  chooses action  $a_j$  (with  $a_j \in A_j$ ) (for all  $j=1,2,\dots,n$ ) and if player  $i$  has type  $t_i \in T_i$

# Bayesian Games: Who Knows What?

We assume that all players enter knowing the full information about the  $A_i$ 's,  $T_i$ 's,  $P_i$ 's and  $u_i$ 's

The  $i$ 'th player knows  $t_i$ , but not  $t_1 t_2 t_3 \cdots t_{i-1} t_{i+1} \cdots t_n$

All players know that all other players know the above

And they know that they know that they know, *ad infinitum*

**Definition:** A strategy  $S_i(t_i)$  in a Bayesian Game is a mapping from  $T_i \rightarrow A_i$ : a specification of what action would be taken for each type

## Example

$$A_1 = \{H, F\}$$

$$A_2 = \{H, F\}$$

$$T_1 = \{H\text{-love}, \text{Flove}\}$$

$$T_2 = \{H\text{love}, \text{Flove}\}$$

$$P_1(t_2 = H\text{love} \mid t_1 = H\text{love}) = 2/3$$

$$P_1(t_2 = \text{Flove} \mid t_1 = H\text{love}) = 1/3$$

$$P_1(t_2 = H\text{love} \mid t_1 = \text{Flove}) = 2/3$$

$$P_1(t_2 = \text{Flove} \mid t_1 = \text{Flove}) = 1/3$$

$$P_2(t_1 = H\text{love} \mid t_2 = H\text{love}) = 1$$

$$P_2(t_1 = \text{Flove} \mid t_2 = H\text{love}) = 0$$

$$P_2(t_1 = H\text{love} \mid t_2 = \text{Flove}) = 1$$

$$P_2(t_1 = \text{Flove} \mid t_2 = \text{Flove}) = 0$$

$$u_1(H, H, H\text{love}) = 2$$

$$u_2(H, H, H\text{love}) = 2$$

$$u_1(H, H, \text{Flove}) = 1$$

$$u_2(H, H, \text{Flove}) = 1$$

$$u_1(H, F, H\text{love}) = 0$$

$$u_2(H, F, H\text{love}) = 0$$

$$u_1(H, F, \text{Flove}) = 0$$

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$$u_1(F, H, H\text{love}) = 0$$

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$$u_1(F, F, H\text{love}) = 1$$

$$u_2(F, F, H\text{love}) = 1$$

$$u_1(F, F, \text{Flove}) = 2$$

$$u_2(F, F, \text{Flove}) = 2$$

(GASP, SPLUTTER)

# Bayesian Nash Equilibrium

The set of strategies  $(s_1^*, s_2^* \cdots s_n^*)$  are a

Pure Strategy Bayesian Nash Equilibrium

iff for each player  $i$ , and for each possible type of  $i : t_i \in T_i$

$$s_i^*(t_i) =$$

$$\arg \max_{a_i \in A_i} \sum_{t_{-i} \in T_{-i}} u_i(s_1^*(t_1), \dots, s_{i-1}^*(t_{i-1}), a_i, s_{i+1}^*(t_{i+1}), \dots, s_n^*(t_n)) \times P_i(t_{-i} | t_i)$$

i.e. no player, in any of their types, wants to change their strategy

# NEGOTIATION: A Bayesian Game

Two players:      S, (seller) and  
                         B, (buyer)

$T_s = [0, 1]$       the seller's type is a real number between 0  
                         and 1 specifying the value (in dollars) to them  
                         of the object they are selling

$T_b = [0, 1]$       the buyer's type is also a real number. The  
                         value to the buyer.

Assume that at the start

$V_s \in T_s$  is chosen uniformly at random

$V_b \in T_b$  is chosen uniformly at random

# The “Double Auction” Negotiation

S writes down a price for the item ( $g_s$ )

B simultaneously writes down a price ( $g_b$ )

Prices are revealed

If  $g_s \geq g_b$  no trade occurs, both players have payoff 0

If  $g_s \leq g_b$  then buyer pays the midpoint price  $\frac{(g_s + g_b)}{2}$  and  
receives the item

Payoff to S :  $1/2(g_s + g_b) - V_s$

Payoff to B :  $V_b - 1/2(g_s + g_b)$

# Negotiation in Bayesian Game Notation

$T_s = [0,1]$  write  $V_s \in T_s$

$T_b = [0,1]$  write  $V_b \in T_b$

$P_s(V_b|V_s) = P_s(V_b) = \text{uniform distribution on } [0,1]$

$P_b(V_s|V_b) = P_b(V_s) = \text{uniform distribution on } [0,1]$

$A_s = [0,1]$  write  $g_s \in A_s$

$A_b = [0,1]$  write  $g_b \in A_b$

$u_s(P_s, P_b, V_s) =$

What?

$u_b(P_s, P_b, V_b) =$

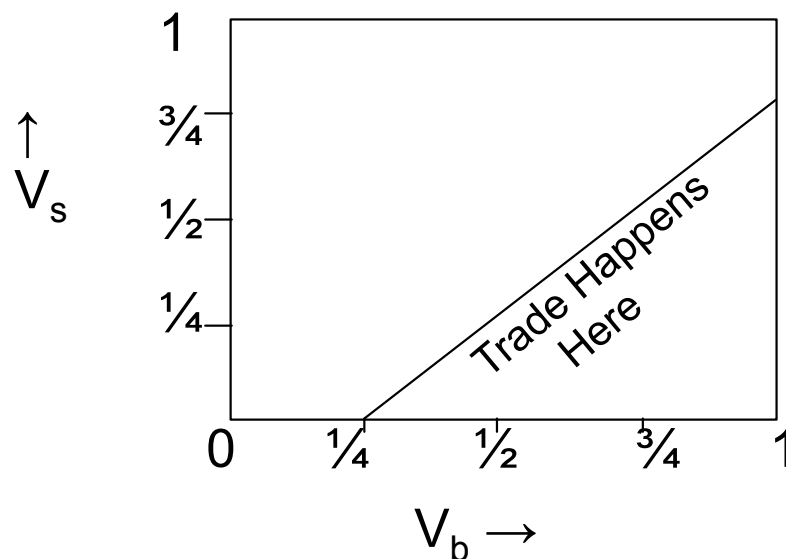
What?

# Double Negotiation: When does trade occur?

...when

$$g_b^*(V_b) = 1/12 + 2/3 V_b > 1/4 + 2/3 V_s = g_s^*(V_s)$$

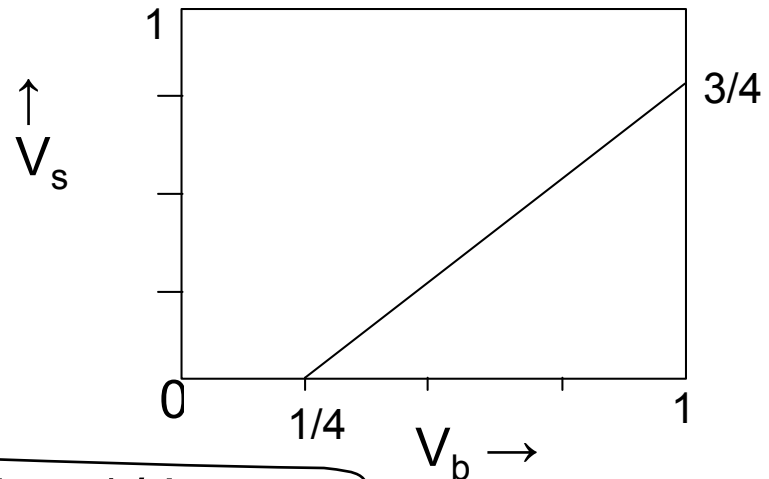
i.e. when  $V_b > V_s + 1/4$



$$\text{Prob(Trade Happens)} = 1/2 \times (3/4)^2 = 9/32$$



# Value of Trade



$$E[V_s | \text{Trade Occurs}] = 1/3 \times 3/4 = 1/4$$

$$E[V_b | \text{Trade Occurs}] = 1/4 + 2/3 \times 3/4 = 3/4$$

If trade occurs, expected trade price is

$$1/2[g_s^*(V_s) + g_b^*(V_b)] =$$

$$1/2(1/12 + 2/3V_b + 1/4 + 2/3V_s) =$$

$$1/6 + 1/3V_b + 1/3V_s$$

# Value of Trade continued...

$E[\text{profit to S} \mid \text{trade occurred}] =$

$E[1/6 + 1/3V_b + 1/3V_s - V_s \mid \text{trade occurred}] =$

$1/6 + 1/3E[V_b \mid \text{trade}] - 2/3E[V_s \mid \text{trade}] =$

$1/6 + 1/3 \times 3/4 - 2/3 \times 1/4 = 1/4$

---

**Similar Algebra Shows:**  $E[\text{profit to B} \mid \text{trade occurred}] = 1/4$  also

---

## Using This Game

$E[\text{B's profit}] = 1/4 \times 9/32 = 0.07$

$E[\text{S's profit}] = 0.07$

## If Both Were “Honest”

$E[\text{B profit}] = 1/12 = 0.083$

$E[\text{S profit}] = 1/12 = 0.083$

---

This Game seems **inefficient**. What can be done???

# Double Auction: Final Comments

- There are other Nash Equilibrium strategies.
- But the one we saw is provably most efficient.
- In general, even for arbitrary prob. dists. of  $V_s$  and  $V_b$ , no efficient NE's can exist.
- And no other games for this kind of trading can exist and be efficient.

# Double Auction Discussion

What if seller used “giant eagle” tactics?

Seller states “I’ll sell it to you for price  $p$  : take it or leave it”

## Exercise:

- How should\* seller choose price (taking into account  $V_s$  of course) ?
- And how should\* buyer choose whether to buy ?  
\*(at a B.N.E.)
- **When could/should double auction technology be used?**
- **(How) can “ $V_s, V_b$  drawn randomly from  $[0,1]$ ” be relaxed ?**



# First Price Sealed Bid

Seller wants to sell an object that has no value to seller... anything seller is paid is pure profit.

There are  $n$  available buyers

## Assumptions:

- Assume buyer  $i$  has a value for the object distributed uniformly randomly in  $[0...1] \ni V_i$
- Assume  $V_i$ 's all independent
- Buyer  $i$  does not know  $V_j$  for  $i \neq j$
- Buyer  $i$  does know all  $V_j$ 's randomly generated from  $[0,1]$

# First Price Sealed Bid Rules

Each buyer writes down their bid.

Call buyer  $i$ 's bid  $g_i$

Buyer who wrote highest bid must buy object from seller at price=bid

**Question:** Why is “bid =  $V_i$ ” a stupid strategy ??

# Auction Analysis: Back to Bayesian Nash Equils

We'll assume that all players other than  $i$  do a linear strategy:

$$g_j^*(V_j) = m_j V_j \quad \text{for } j \neq i$$

Then what should  $i$  do ?

This assumption is completely unjustified right now. Later we'll see why it was an okay assumption to make.



$$g_i^*(v_i) = \arg \max_g E \left[ \begin{array}{c} \text{Profit if} \\ \text{play } g \end{array} \right]$$

$$\begin{aligned}
g_i^*(v_i) &= \arg \max_g E \left[ \begin{array}{c} \text{Profit if} \\ \text{play } g \end{array} \right] \\
&= \arg \max_g E \left[ \begin{array}{c} \text{Profit if} \\ \text{play } g \end{array} \middle| i \text{ wins} \right] \text{Prob} \left[ \begin{array}{c} g \text{ is} \\ \text{winning bid} \end{array} \right] \\
&= \arg \max_g \underbrace{\hspace{10em}}_{\text{what?}} \times \underbrace{\hspace{10em}}_{\text{what?}} \\
&\quad \boxed{?}
\end{aligned}$$

$$\begin{aligned}
&= g \text{ such that } (n-1)(v_i - g)g^{n-2} - g^{n-1} = 0 \\
&\Rightarrow g_i^*(v_i) = \left(1 - \frac{1}{n}\right)v_i
\end{aligned}$$

$$\begin{aligned}
g_i^*(v_i) &= \arg \max_g E \left[ \begin{array}{c} \text{Profit if} \\ \text{play } g \end{array} \right] \\
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&\quad \boxed{?}
\end{aligned}$$

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&\Rightarrow g_i^*(v_i) = \left(1 - \frac{1}{n}\right)v_i
\end{aligned}$$

Thus we've an N.E. because if all other players use a linear strategy then it's in  $i$ 's interest to do so too. Above holds  $\forall i$

See, I told you the linear assumption would be okay.

# First-Price Sealed Auction

At BNE all players use

$$g_i^*(V_i) = (1 - 1/n)V_i$$

Note: [Fact of probability]

Expected value of the largest of  $n$  numbers drawn independently from  $[0,1]$  is  $\frac{n}{n+1}$

Expected profit to seller = **what?**

# First-Price Sealed Auction

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$n+1$

Expected profit to seller =

Expected highest bid = **what?**

# First-Price Sealed Auction

At BNE all players use

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$$\frac{n}{n+1}$$

Expected profit to seller =

Expected highest bid =

$$\left(1 - \frac{1}{n}\right) \left(\frac{n}{n+1}\right) = 1 - \frac{2}{n+1}$$



**Exercise:** compute expected profit to player  $i$ . Show it is  $O(1/n)$ .

# Second-Price Sealed Bid

A different game:

Each buyer writes their bid

Buyer with highest bid must buy the object

But the price they pay is the second highest bid

- What is player  $i$ 's best strategy
- Why?
- What is seller's expected profit?

# Auction Comments

- Second-price auction is preferred by cognoscenti
  - No more efficient
  - But general purpose
  - And computationally better
  - And less variance (better risk management)
- Auction design is interesting
  - So far mostly for economics
  - But soon for e-commerce etc.?
- Important but not covered here
  - Expertise
  - Collusion
  - Combinatoric Auctions
  - What if all cooperative ????



# What You Should Know

Strict dominance

Nash Equilibria

Continuous games like Tragedy of the Commons

Rough, vague, appreciation of threats

Bayesian Game formulation

Double Auction

1<sup>st</sup>/2<sup>nd</sup> Price auctions

# What You Shouldn't Know

- How many goats your lecturer has on his property
- What strategy Mephistopheles uses in his negotiations
- What strategy this University employs when setting tuition
- How to square a circle using only compass and straight edge
- How many of your friends and colleagues are active Santa informants, and how critical they've been of your obvious failings