COMMUNICATION IN GLOBAL GAMES: THEORY AND EXPERIMENT*

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Abstract

This paper introduces communication as a strategic choice for participants in global games, which are used to study a variety of socio-economic phenomena. I characterize the resulting equilibria and test the theoretical predictions in a laboratory setting. Introducing simultaneous two-sided cheap-talk communication induces an informative equilibrium in which individuals share their intended actions. Cheap-talk communication studied in this paper improves welfare by reducing two types of inefficiencies present in global games: (i) the payoff-dominant equilibrium is selected instead of risk-dominant one, and hence the inefficiency region is collapsed; and (ii) miscoordination is reduced because players' actions are more correlated. The experimental results provide support for qualitative features of the informative equilibrium. All communication protocols significantly reduce miscoordination. Despite the decrease in miscoordination, one-stage communication protocols have mixed effects on welfare; however, multi-stage cheap-talk provides significantly higher welfare.

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