

Game theory

Siddharth Bhat

Spring 2020

Contents

1	Introduction	5
1.1	Normal form games	5
1.1.1	Normal form for matching coins with observation	6
1.1.2	Normal form for matching coins without observation	6
1.1.3	Normal form for prisoners dilemma	6
2	Game analysis	7
2.0.1	Common knowledge and puzzles about common knowledge	7
2.0.2	Strongly dominated strategy	7
2.0.3	Strongly dominant strategy	7
2.0.4	Weakly dominated strategy	8
2.0.5	Weakly dominant strategy	8
2.0.6	Very weakly dominated strategy	9
2.0.7	Example of strong dominance in prisoners dilemma	9
2.0.8	Another game	9
2.0.9	Can there exist two weakly dominant strategies?	9
2.0.10	Strongly (Weakly) Dominant Strategy Equilibrium	9
3	Lecture 2	11
3.1	Review of lecture 2	11
4	Equilibrium in two-player zero-sum games	13
4.1	Saddle points	13
4.1.1	Analysis of saddle points	14
4.2	Mixed strategies	15
4.3	Axiomatic description of utility theory	15
4.4	Best response function	16
4.5	Nash equilibrium	16
4.6	Writing down the Nash Equilibrium in terms of an LP	16
4.7	Kakutani fixed point theorem	16
4.8	Existence of Nash equilibrium	17
4.9	Existence of Nash equilibrium (Insightful version)	17
4.10	LP formulation for 2 player zero sum game	17
4.11	Lemke Howson theorem for computing mixed-strategy nash eqm	17

4.12	Mechanism design	17
5	March 23rd	19
5.1	Examples of SCF in quasi-linear settings	19
5.2	Allocative efficiency	19
5.3	Properties of SCF(Social choice function) in quasi-linear settings	19
5.4	Ex-post efficiency	20
5.5	Other way round: if f is AE + SBB, then it is EPE	20
5.6	First price versus second price auction	20
5.7	Groves theorem	21
5.8	Clarke's mechanism	21
6	March 26th	23
7	March 30th	25

Chapter 1

Introduction

TODO: find out and write about: Extrinsic form representation of a game $\Gamma \equiv \langle N, T, Z, o, A, s, u_i, \mathcal{H} \rangle$ where N is number of players, T is game tree, Z is leaves, o is owner function, A is actions, s is transition, u_i is player function, \mathcal{H} is information sets. An information set contains equivalence classes of states that the player cannot distinguish between. There can be ambiguity due to missing information. Perfect information game is one where all information sets are singleton. For example, chess is perfect information. Example of partial information is card games.

Next, we look at strategies. A strategy is a computable function by which each player selects their actions.

Game tree for matching coins with observation: $S_A : \{1\} \rightarrow \{H, T\}$. $S_B : \{2, 3\} \rightarrow \{H, T\}$.

Game tree for matching coins without observation: $S_A : \{1\} \rightarrow \{H, T\}$. $S_B : \{\{2, 3\}\} \rightarrow \{H, T\}$.

We let $S \equiv S_1 \times S_2 \times \dots \times S_n$. This is a set containing all possible strategies, called as a "strategy profile", $s \in S$. We write s as $s \equiv (s_i, s_{-i})$, where s_{-i} is cute notation for "the rest of the players". For example, if $s \equiv (s_1, s_2, s_3)$ we can notate $s = (s_2, s_{-2}) = (s_2, s_1, s_3)$.

We will currently focus on pure strategies, where we have a deterministic function per strategy.

1.1 Normal form games

Another representation for games is called as strategic form / matrix form / normal form games. Here, a game $\Gamma \equiv \langle N, (S_i)_{i \in N}, (u_i : S \rightarrow \mathbb{R})_{i \in N} \rangle$. N is the number of players, S_i are strategies for each player, u_i are the utility functions / payoffs for each player. u_i maps each strategy profile s how worth it is for player i if the game proceeds with strategy profile s .

1.1.1 Normal form for matching coins with observation

$$\begin{aligned}
S_a &\equiv \{S_a^1(H), S_a^2(T)\} \\
S_b &\equiv \{S_b^1(HH), S_b^2(HT), S_b^3(TH), S_b^4(TT)\} \\
u_a : S &\rightarrow \mathbb{R} \\
u_a((s_a^1, s_b^1)) &= +10 & (H, HH) \\
u_a((s_a^1, s_b^2)) &= +10 & (H, HT) \\
u_a((s_a^1, s_b^3)) &= -10 & (H, TH) \\
u_a((s_a^1, s_b^4)) &= -10 & (H, TT) \\
u_a((s_a^2, s_b^1)) &= -10 & (T, HH) \\
u_a((s_a^2, s_b^2)) &= +10 & (T, HT) \\
u_a((s_a^2, s_b^3)) &= -10 & (T, TH) \\
u_a((s_a^2, s_b^4)) &= +10 & (T, TT)
\end{aligned}$$

Alternate representation of same game:

$s_b \rightarrow$	HH	HT	TH	TT
H	(10, -10)	(10, -10)	(-10, +10)	(-10, +10)
T	(-10, 10)	(10, -10)	(-10, 10)	(10, -10)

1.1.2 Normal form for matching coins without observation

$s_a \rightarrow$	H	T
H	(10, -10)	(-10, 10)
T	(-10, 10)	(10, -10)

1.1.3 Normal form for prisoners dilemma

C for confess, NC for not confess.

	C	NC
C	(-5, -5)	(-1, -10)
NC	(-10, -1)	(-2, -2)

Chapter 2

Game analysis

Rationality implies that each player is motivated to maximise his own payoff. Intelligent implies that player can take into account all available information. An intelligent and rational player implies that every player will attempt to maximise their utility.

2.0.1 Common knowledge and puzzles about common knowledge

Definition 1 Common knowledge — *Player knows it. Every player knows that every player knows it. Every player knows that every player knows that every player knows it. $\forall k \in \mathbb{N}, (\text{Every player knows that})^k$ every player knows it.*

If we have an island with two water streams and all humans and intelligent, rational and cannot speak. They have a rule that says that if a person has a blue mark on their forehead, the drink water from a stream farther away. One day, a visitor, who knows the above fact, shouts "why is a person with a blue mark drinking water here?" The next day, no one comes to the stream. What changed? The only difference before and after is that it is now common knowledge that there is one person with a blue mark drinking water at the stream. This

Some one imagined two positive whole numbers $1 \leq a, b \leq 20$. He tells the sum of these two numbers to mathematician A, the product of these numbers to mathematician B. A tells B that there is no way for B to know the sum. Then B exclaims "But I know the sum now!", to which A exclaims "and now I know the product".

2.0.2 Strongly dominated strategy

Given a game $\Gamma \equiv \langle N, (S_i), (u_i) \rangle$, a strategy $s_i \in S_i$ is said to be strongly dominated by a strategy $s'_i \in S_i$ if:

$$u_i(s_i, s_{-i}) < u_i(s'_i, s_{-i}) \quad \forall s_{-i} \in S_{-i}$$

2.0.3 Strongly dominant strategy

Given a game $\Gamma \equiv \langle N, (S_i), (u_i) \rangle$, a strategy s_i^* is said to be strongly dominant if it strongly dominates every other strategy $s_i \in S_i$.

$$\forall s_i \in S_i, s_i \neq s_i^* \implies u_i(s_i, s_{-i}) < u_i(s_i^*, s_{-i}) \quad \forall s_{-i} \in S_{-i},$$

Note that to analyze strongly dominated and strongly dominant strategies, we only need u_i , the utility of the i th player. Hence, to analyze dominance of strategies, we can get away with writing the utility of just a single player.

	L	R
A	6, -	7, -
B	5, -	6, -
C	4, -	6, -

L, R are moves of the player. A, B, C are strategies with utilities filled in.

A strongly dominates C, A strongly dominates B. B does *not* strongly dominate C, since on the R action, we have 6 for both B and C. Hence, A is the strongly dominant strategy. Note that there need not always exist a strongly dominant strategy:

	L	R
A	6, -	7, -
B	7, -	6, -

Neither A nor B are strictly better than the other.

2.0.4 Weakly dominated strategy

Given a game $\Gamma \equiv \langle N, (S_i), (u_i) \rangle$, a strategy $s_i \in S_i$ is said to be weakly dominated by a strategy $s_i' \in S_i$ if:

$$u_i(s_i, s_{-i}) \leq u_i(s_i', s_{-i}) \quad \forall s_{-i} \in S_{-i}$$

with strict inequality for at least one s_{-i} .

2.0.5 Weakly dominant strategy

Given a game $\Gamma \equiv \langle N, (S_i), (u_i) \rangle$, a strategy s_i^* is said to be weakly dominant if it weakly dominates every other strategy $s_i \in S_i$.

$$\forall s_i \in S_i, s_i \neq s_i^* \implies u_i(s_i, s_{-i}) \leq u_i(s_i^*, s_{-i}) \quad \forall s_{-i} \in S_{-i},$$

with strict inequality for at least one s_{-i} .

Once again, a weakly dominant strategy need not always exist:

	L	R
A	6, -	7, -
B	7, -	6, -

2.0.6 Very weakly dominated strategy

Given a game $\Gamma \equiv \langle N, (S_i), (u_i) \rangle$, a strategy $s_i \in S_i$ is said to be very weakly dominated by a strategy $s'_i \in S_i$ if:

$$u_i(s_i, s_{-i}) \leq u_i(s'_i, s_{-i}) \quad \forall s_{-i} \in S_{-i}$$

Note that we do not have the strict inequality requirement anymore. This is now a true partial order.

2.0.7 Example of strong dominance in prisoners dilemma

	C	NC
C	(-5, -5)	(-1, -10)
NC	(-10, -1)	(-2, -2)

Here, C is the strongly dominant strategy for both players.

2.0.8 Another game

	a	b	c
A	5	5	5
B	4	5	5
C	4	4	4

There does not exist a strongly dominant strategy. A is weakly dominant. C is weakly dominated by both A, B.

2.0.9 Can there exist two weakly dominant strategies?

No there cannot. If A is a weakly dominant strategies, then assume $A[i] > B[i]$. If $A[i] > B[i]$, then B cannot weakly dominate A, since for B to dominate A we need $B[j] \geq A[j] \quad \forall j$, but $B[i] < A[i]$.

2.0.10 Strongly (Weakly) Dominant Strategy Equilibrium

A strategy profile $(s_1^*, s_2^*, \dots, s_n^*)$ is called as a strongly dominant strategy equilibrium of the game $\Gamma \equiv \langle N, (S_i), (u_i) \rangle$ iff the strategy s_i^* is a strongly dominating strategy for player i.

Recall the example of Prisoners dilemma —

	C	NC
C	(-5, -5)	(-1, -10)
NC	(-10, -1)	(-2, -2)

Chapter 3

Lecture 2

Missed! write this down. TODO!

3.1 Review of lecture 2

Two player zero sum games. $N = \{1, 2\}$. $u_1 = -u_2$. Also called matrix games since the game can be represented as a matrix. a_{ij} is the utility for row player playing row i , column player is playing column j .

We showed that we are not guaranteed a dominant strategy. Hence, we need to look at other types of equilibria.

Here, we define saddle points.

Chapter 4

Equilibrium in two-player zero-sum games

4.1 Saddle points

Given a matrix A , (i^*, j^*) is a saddle point iff:

$$\begin{aligned} a_{i^*j^*} &\leq a_{i^*k} & \forall k = 1, 2, \dots, n \\ a_{i^*j^*} &\geq a_{lj^*} & \forall l = 1, 2, \dots, m \end{aligned}$$

That is, $a_{i^*j^*}$ is the maximum in the column j^* , minimum in the column i^* .

Let's now analyze the setting and try to deduce when a saddle point exists from the entries of the matrix. For this, we define:

$$\begin{aligned} u_R &\equiv \max_i \min_j a_{ij} \\ u_C &\equiv \min_j \max_i a_{ij} \end{aligned}$$

Lemma 2 *If there are multiple saddle points, (i_1, j_1) and (i_2, j_2) , then $a_{i_1j_1} = a_{i_2j_2}$*

Proof 3 *Let $a[c][d], a[p][q]$ be two saddle points. By definition, a saddle point is greater than everything else on the same row, and less than everything else on the same column.*

$$\begin{bmatrix} (c, d) & > & (c, q) \\ \wedge & & \vee \\ (p, d) & < & (p, q) \end{bmatrix}$$

We see that $(c, d) > (c, q) > (p, q)$, and $(c, d) < (p, d) < (p, q)$, which implies $(c, d) = (p, q)$.

Lemma 4 $u_R \leq u_C$

Proof 5 *TODO*

Lemma 6 $u_r = u_c \implies$ saddle point exists for A.

Proof 7 Consider $u_R \equiv \max_i \min_j a[i][j]$. Let us introduce a symbol $\min R(i) \equiv \min_j a[i][j]$ Hence, $u_R = \max_i \min R(i)$. This shows us that u_R is the minimum value in its row.

Similarly, we consider $u_C \equiv \max_i \min_j a[i][j]$. As before, introduce $\max C(j) \equiv \max_i a[i][j]$ Hence, $u_C = \min_j \max C(j)$. Hence, u_C is the maximum value in its column (Notice the duality).

Let (c, d) be the index of u_R , and (p, q) be the index of u_C .

Now consider the matrix:

$$\left[\begin{array}{cc} (c, d) & < & (c, q) \\ & \wedge & \\ & & (p, q) \end{array} \right]$$

Hence, $(c, d) \leq (c, q)$ (Since $u_R = a[c][d]$ is minimum in its row). $(c, q) \leq (p, q)$ (Since $u_C = a[p][q]$ is maximum in its column). Therefore, $u_R = (c, d) \leq (c, q) \leq (p, q) = u_C$.

Lemma 8 $u_r = u_c \iff$ saddle point exists for A.

Proof 9 TODO

4.1.1 Analysis of saddle points

If a saddle point exists, then the row player is maximising her minimum assured gain. The column player is minimising her worst loss.

If such a saddle point exists, it is called as an equilibrium. The strategy that achieves this is the **mini-max** strategy.

Single saddle point

A ↓ B →	L	M	R	
T	1	2	1	$(u_r \equiv 2, u_c \equiv 2)$.
M	0	-1	2	
B	-1	0	-2	

Multiple saddle points

	L	M	R	
T	0	2	0	There are 4 saddle points: (T, L), (T, R), (B, L), (B, R).
M	-1	5	2	
B	0	5	0	

Matching coins — no saddle point

	H	T	
H	10	-10	$(u_R \equiv -10, u_C \equiv 10)$ — no saddle point!
T	-10	10	

Here, notice that no deterministic strategy can win. What we should do is to use a randomized strategy where we play H or T with equal probability.

4.2 Mixed strategies

As the matching coins example shows, we need to use a randomized strategy so we are not exploited. What we can do is to maximise expected utility:

The expected utility of the row player is going to be $\mathbb{P}[H, H] - \mathbb{P}[H, T] - \mathbb{P}[T, H] + \mathbb{P}[T, T]$.

The mixed strategy space consists of probability distributions over pure strategies.

$$\Delta(S) \equiv \left\{ (p_1, p_2, \dots, p_k) \mid |S| = k \quad p_i \geq 0 \quad \sum_i p_i = 1 \right\}$$

We denote mixed strategies with $\sigma_i \in \Delta(S_i)$, and mixed strategy profiles as $\sigma \equiv (\sigma_1, \sigma_2, \dots, \sigma_n) \in \prod_i \Delta(S_i)$

We calculate the expected utility as:

$$U_i(\sigma_i, \sigma_{-i}) \equiv \sum_{s_{-i} \in S_{-i}} p_{i_1} p(s_{-i}) u(a_{i_1}, s_{-i}) + p_{i_2} p(s_{-i}) u(a_{i_2}, s_{-i}) + \dots + p_{i_k} p(s_{-i}) u(a_{i_k}, s_{-i})$$

For two-player zero-sum games, we refer to mixed strategies as $p \equiv (p_1, \dots, p_m)$, $q \equiv (q_1, \dots, q_n)^T$. This leads us to **Utility theory**.

4.3 Axiomatic description of utility theory

Let X be the set of outcomes. \geq (TODO: curly, need to find this) be the preference of the player over the set of outcomes. We define $(x_1 \sim x_2 \equiv x_1 \geq x_2 \wedge x_2 \geq x_1)$.

TODO: find formal definition of a lottery.

- Completeness: every pair of outcomes is ranked.
- Transitivity: $x_1 \geq x_2 \wedge x_2 \geq x_3 \implies x_1 \geq x_3$.
- Substitutability: if $x_1 \sim x_2$, then any lottery in which x_1 is substituted by x_2 is equally preferred.
- Decomposability: If two lotteries assign the same probability to each outcome, then the player is indifferent between these two lotteries.
- Monotonicity: If $x_1 > x_2$ and $p > q$, then $[x_1 : p, x_2 : 1 - p] \geq [x_1 : q, x_2 : 1 - q]$.
- Continuity: If $x_1 > x_2 > x_3$, then there exists $p \in [0, 1]$ such that $x_2 \sim [x_1 : p, x_3 : 1 - p]$.

Theorem 10 *Von Neumann and Morgenstern: Given a set of outcomes X has a preference relation on X that satisfies the above axioms, there exists a utility function $u : X \rightarrow [0, 1]$ such that:*

- $u(x_1) \geq u(x_2) \iff x_1 \geq x_2$
- $U([x_1 : p_1, x_2 : p_2, \dots, x_m : p_m]) = \sum_{j=1}^m p_j u(x_j)$

4.4 Best response function

Let $\Gamma \equiv (N, S_{i \in N}, u : \prod_i S_i \rightarrow \mathbb{R})$ be a normal form game. We define the best response function for player i as:

$$r_i : S_{-i} \rightarrow S_i \quad r_i(s_{-i}) \equiv \operatorname{argmax}_{s_i \in S_i} u(s_i, s_{-i})$$

That is, under a fixed strategy for all of i 's opponents, the best response function $r_i(s_{-i})$ tells us the best move we can make.

4.5 Nash equilibrium

A strategy profile $s \equiv (s_1, s_2, \dots, s_n)$ is a Nash equilibrium if s_i is the best response to s_{-i} for all i .

4.6 Writing down the Nash Equilibrium in terms of an LP

Let K_i be the set of actions that player i will take (the support). Let $p_i[s]$ be the probability for player i to take action $s \in S_i$.

We need the conditions:

- $\forall s \notin K_i, p_i[s] = 0$
- $\sum p_i s = w_i$

4.7 Kakutani fixed point theorem

consider a relation $R : \Sigma \rightrightarrows \Sigma$ such that:

- Σ is compact, convex, and nonempty.
- $R(\sigma)$ is nonempty.
- $R(\sigma)$ is convex.
- R has a closed graph.

under these conditions, R is guaranteed to have a fixed point.

4.8 Existence of Nash equilibrium

We prove this using the Kakutani fixed point theorem.

4.9 Existence of Nash equilibrium (Insightful version)

We prove this using the Brouwer fixed-point theorem. While this requires us to roll up our sleeves a little bit, the fixpoint is far more constructive, in the sense that it tells us what the fixpoint is actually, well, fixing.

consider the correspondence

$$R : \Sigma \rightarrow 2^{\Sigma} \quad R(\sigma) \equiv [r_i(\sigma_{-i})]_{i \in N}$$

That is, for each strategy profile σ , we relate it to the set of strategy profiles that are best responses against this profile.

Now note that a Nash equilibrium is a fixed point of this relation. We will show that the above relation R satisfies the assumptions of the Kakutani fixed point theorem, and is hence a fixed point.

4.10 LP formulation for 2 player zero sum game

4.11 Lemke Howson theorem for computing mixed-strategy Nash eqm

4.12 Mechanism design

We consider a setting:

$N \equiv$ Set of players

$X \equiv$ Alternatives

$\Theta_{i \in N} \equiv$ private information of player i

$\phi : \prod_i \Theta_i \rightarrow \mathbb{R} \equiv$ prior probability over private information

$u_{i \in N} : \prod_i \Theta_i \times X \rightarrow \mathbb{R} \equiv$ utility of player i

A mechanism is a tuple:

$\Gamma \equiv (S_{i \in N}, g)$

$S_{i \in N} \equiv$ strategies of each player i

$g : \prod_i S_i \rightarrow X \equiv$ an outcomes function

A mechanism tells us what actions a player can take, and what the outcome of each action is.

We often want the mechanism to be designed to optimised a particular social good:

$$f : \prod_i \Theta_i \rightarrow X \equiv \text{Social choice function}$$

That is, given knowledge of what players *truly want*, we know what outcome we are interested in. In this setting, we are then to design a mechanism (S_i, g) which will encourage a situation where rational players will take action dictated by f .

Sometimes, we will denote S_i by $\hat{\Theta}_i$, since any action the player can take can be mathematically modeled as a deterministic function of their state. Hence, if we allow players to lie and publish a $\hat{\Theta}_i$, which is their reporting of their private Θ_i , it's equivalent to a setting where players have arbitrary S_i .

Chapter 5

March 23rd

We can either relax DSIC or relax rich preference structure. We decided to look at quasi-linear environments where we relax preferences. A popular example of this is auctions.

$$X = \{(k, t_1, \dots, t_n) : k \in K, t_i \in \mathbb{R}, \sum_i t_i \leq 0\}$$

t_i is monetary transfer receives by agent i .

$u_i(x, \theta_i) = v_i(k, \theta_i) + t_i$. Linear in t_i , hence the setting is quasi-linear. Often it is even $k_i \cdot \theta_i + t_i$ — these settings are known as linear settings.

5.1 Examples of SCF in quasi-linear settings

Players Seller and two buyers

Information / valuations Seller $\Theta_0 = \{0\}$. Buyers $\theta_1 = \theta_2 = [0, 1]$.

5.2 Allocative efficiency

An SCF $f()$ is allocative efficient if it maximises sum of valuations of agents. We assume such a maxima does exist. $k^*(\theta) \in \arg \max_{k \in K} \sum_{i=1}^n v_i(k, \theta_i)$

We also want budget balance:

$$\sum_{i=1}^n t_i(\theta) = 0.$$

5.3 Properties of SCF(Social choice function) in quasi-linear settings

Lemma 11 All SCFs in quasi-linear settings are non dictatorial.

because $\sum_i t_i < 0$, we can increase payment for the dictator by using $t_i + \frac{\epsilon}{n-1}$ and decrease everyone else to $t_i - \frac{\epsilon}{n-1}$. So, there is always an outcome that is better for a dictator. Hence, the best outcome cannot have a dictator.

5.4 Ex-post efficiency

in quasi linear, scf is exp-post efficient iff if is allocatively efficient and strictly budget balanced. We have to prove that $EPE \implies AE + SBB$, and also $AE + SBB \implies EPE$.

Suppose $f = (k, t)$ is EPE but not SBB. So there exists a θ such that $\sum_i t_i(\theta) < 0$. Hence, there exists at least one agent j such that $t_j < 0$. (If everyone is positive, sum cannot be less than 0).

Now consider a new allocation $X' = (k, t')$ where

$$t'_j(\theta) = \begin{cases} t_j(\theta) - \sum_i t_i(\theta)/n & \text{if } t_j(\theta) < 0 \\ t_j(\theta) & \text{otherwise} \end{cases}$$

Hence, $u'_j(k, t') > u_j(k, t)$ for such j where $t_j(\theta) < 0$. For other agents, $u'_j(k, t') = u_j(k, t)$.

This means that (k, t') pareto dominates (k, t) . This is a contradiction to the assumption that f was EPE, since we constructed an outcome where one agent does better, and others don't do worse.

We now argue that f must be allocatively efficient, if f is EPE. For contradiction, let us assume that f is not AE. That means that there is a k^* such that $\sum_i v_i(k^*, \theta) > v_i(k, \theta)$.

Define $t'_i(\theta) = v_i(k, \theta) - t_i(\theta) - \sum_j \theta_j(k^*, \theta) + \epsilon$ where $\epsilon < \sum_j v_j(k^*, \theta) - \theta_j(k, \theta)$.

Note that $v_i(k, \theta) - t_i(\theta) = u_i(k, t)$. Now note that $u_i(k^*, t') = u_i(k, t) + \epsilon/n$, where ϵ is positive. Hence, $u_i(k^*, t') > u_i(k, t)$.

We need to check that t' is feasible: ie, $\sum_i t'_i < 0$.

$$\sum_i t'_i = \sum_i v_i(k, \theta) - \sum_i t_i(\theta) - \sum_j \theta_j(k^*, \theta) + \epsilon \leq 0??$$

Also note that for all i , $u_i(k^*, t') > u_i(k, t)$. This is contradiction to the fact that f is APE. Hence, f must be AE.

5.5 Other way round: if f is AE + SBB, then it is EPE

For this, we will need to prove a lemma:

Lemma 12 If $f : \Theta \rightarrow X$ st $\forall \theta \in \Theta$,

$$\sum_i u_i(f(\theta), \theta_i) \geq \sum_i u_i(x, \theta_i) \forall x \in X$$

then f is EPE.

The key idea is to write $u_i = v_i + t_i$, and we can get rid of t_i since f is SBB.

5.6 First price versus second price auction

First price: reporting valuation truthfully is not an equilibrium. Second price: truthful reporting is equilibrium.

How do we generalize this to more situations? The key idea is that in a second price auction, our payment is independent of what we report. The allocation might depend on our payment, but payment does not. How can we have more DSIC mechanisms?

5.7 Groves theorem

TODO: fill up groves theorem

Three families A B C, can go to Munnar or Simla.

	Manali	Shimoga	
Alice	-1	10	
Bob	5	-2	
Claire	5	4	(Claire is a kid, loves vacations)

We want to get this information truthfully, by using VCG/Groves mechanism.

there are two outcomes, M or S. If we go to M, the utility is $5+5-1=9$. If we choose S, it is $10-2+4=12$. so S is allocatively efficient.

	{A}	{B}	{C}	{A, B}	{A, C}	{B, C}	{A, B, C}
P ₁	10	0	5	10	20	5	20
P ₂	0	9	15	9	15	20	20
P ₃	10	2	2	10	12	2	28
P ₄	8	3	3	8	8	3	8

Giving A to P₁ and BC to P₂ gives $10 + 20 = 30$.

A direct revelation mechanism in which f satisfies allocative efficiency and the groves payment scheme is known as the groves mechanism.

before this, there is another mechanism called as Clarke's mechanism

5.8 Clarke's mechanism

$$h_i(\theta_i) = \sum_{j \neq i} v_j(k_{-i}^*(\theta_{-i}, \theta_j)) \forall \theta_{-i} \in \Theta_{-i}$$

That is, each agent i receives

$$t_i(\theta) = \sum_{j \neq i} (v_j(k^*(\theta), \theta_j)) - \sum_{j \neq i} v_j(k_{-i}^*(\theta_{-i}, \theta_j))$$

This works for combinatorial auctions as well. It's a generalization of second-price auction.

	M	S	
A	-1	10	
B	5	-2	
C	5	4	(C is a kid, loves vacations)

For player A, first consider:

	M	S	
A	-	-	
B	5	-2	
C	5	4	(C is a kid, loves vacations)

AE is M.

Following Clarke mechanism:

$$t_A = [\text{valuation of remaining agents at allocatively efficient outcome without A}](-2 + 4) - [\text{valuation of remaining agents at outcome M}]$$

for player B, first consider:

A -1 10

B - -

C 5 4 (C is a kid, loves vacations)

M S

AE is S.

So, $t_B = 0$

Similarly, $t_C = 0$.

Chapter 6

March 26th

AE + SBB \implies EPE

Free disposal.

Groves mechanism is DSIC.

Proof by contradiction. Assume f is not DSIC. Hence there exists an $i, \theta, \theta', \theta_{-i}$ such that:

$$u_i(f(\theta^{i'}, \theta_{-i}), \theta_i) > u_i(f(\theta^i, \theta_{-i}), \theta_i)$$

Clarke's pivotal mechanism. This mechanism applied to combinatorial setting is called as generalized Vickrey auction when.

Is a DSIC also a BIC? Yes.

Vickery(single item auction) \subseteq GVN(combinatorial auction) \subseteq Clarke \subseteq Groves \subseteq DSIC \subseteq BIC

Groves theorem says Groves \subseteq AC \cap DSIC Green-laffont proved that AE \subseteq DSIC \subseteq Groves

Green-laffont also proved the Green-Laffont impossibility theorem: that $AE \cap DSIC \cap SBB = \emptyset$.

EPE = ex-post efficient.

Chapter 7

March 30th

N players, Θ_i iid. $k_i(\theta) = 1$ if agent gets the objects, 0 otherwise. $t_i(\theta) =$ payment received by agent i . $u_i(\theta) = k_i(\theta) - t_i(\theta)$