Analysis of a Dynamic Voluntary Contribution Mechanism Public Good Game

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Abstract: I present a dynamic, voluntary contribution mechanism, public good game and derive its potential outcomes. In each period, players endogenously determine contribution productivity by engaging in costly investment. The level of contribution productivity carries from period to period, creating a dynamic link between periods. The investment mimics investing in the stock of technology for producing public goods such as national defense or a clean environment. After investing, players decide how much of their remaining money to contribute to provision of the public good, as in traditional public good games. I analyze three kinds of outcomes of the game: the lowest payoff outcome, the Nash Equilibria, and socially optimal behavior. In the lowest payoff outcome, all players receive payoffs of zero. A Nash Equilibrium occurs when players invest any amount and contribute all or nothing depending on the contribution productivity. Therefore, there are infinitely many Nash Equilibria strategies. Finally, the socially optimal result occurs when players invest everything in early periods, then at some point switch to contributing everything. My goal is to discover and explain this point. I use mathematical analysis and computer simulation to derive the results.

1. INTRODUCTION

In this paper, I present a dynamic, voluntary contribution mechanism, public good game and solve it for the lowest payoff, Nash Equilibria and socially optimal outcomes. While the lowest payoff and Nash Equilibria cases are relatively straightforward, I concentrate on the socially optimal outcome. I build a mathematical model, simplify it, then use computational methods and regression analysis to derive an analytical solution.

Public goods are goods that are non-excludable and non-rival in consumption. Non-excludability means that people cannot be excluded or restricted from using the good. Non-rivalry means that the use of the good by one individual does not reduce its availability to others. One simple example of a public good is a hurricane siren in a small town. No one can be excluded from using the siren and the use of the siren does not affect its availability to other people. Another example of a public good is an open sourced, open licensed software. It is almost impossible to exclude people from using the software and the use of the software by anyone does not affect its availability to anyone else.

The challenge associated with the voluntary provision of public goods is the free rider problem. The problem occurs when those who benefit from a public good or service do not pay for it or do not contribute to it. This leads to the non-production or under-provision of a good or service. As long as this problem is not solved, the voluntary provision of the public good may be ineffective and unsuccessful.

Consider the example of national defense. This good is public since it is neither rival nor excludable. The free rider problem may occur if a part of the society decides not to pay for it. The good will remain public, but provision of the good will be hurt due to the lack of contributions. Moreover, the other people, those who pay, will have an incentive to stop paying too as they might not want to pay for "free riders".

Consider an example of a public good that needs contributions in order to operate. Wikipedia is an open platform where people can post articles and other people can read them. While the service is free, it does need resources, technology and infrastructure to operate. Wikipedia needs thousands of high qualified encyclopedists, millions of dollars and a team of software engineers to function. All of these resources are provided voluntarily, thus, keeping the good non-excludable.

It is important to understand people's behavior when they decide whether or not to contribute to a public good. It is always tempting to avoid contributing, thus, become a free rider. To understand this behavior it is helpful to analyze how the equilibrium may be achieved, what the lowest possible payoff is, and how to achieve socially optimal behavior. This analysis is a primary goal of the paper.

A number of experiments were conducted on the free rider problem and public good provision. Gerald Marwell and Ruth E. Ames test a strong free rider hypothesis by a series of 12 experiments and find it not applicable to real world situations [Marwell and Ames (1981)]. Isaac, Thomas and Walker attempt to reconcile divergent experimental results

of other papers - those which concluded that individuals always free ride a lot, free ride a little or never free ride. They conclude that contribution decision depends on the conditions of the experiment [Isaac, Walker and Thomas (1984)]. John O Ledyard has a chapter in his textbook dedicated to public good games experiments. He carefully describes how such experiments need to be conducted, and how certain aspects of experimental setup affect the end results [Ledyard (1995)]. Finally, Ananish Chaudhuri surveys a large number of papers on public good games in his work. He analyses the effectiveness of monetary and non-monetary punishments on sustaining cooperation in public good games. He concludes that monetary punishments are generally effective, however, there are certain caveats such as cost-effectiveness of the punishment itself and the issue of "anti-social" punishments. He concludes that there are other, non-monetary, punitive measures such as expressions of disapproval or social exclusion [Chaudhuri (2011)].

To analyze people's decision-making regarding contributing to public goods, I have examined the game of Ngo and Smith (2016). In the following sections I will describe the game and its rules, and provide an example of one period (round) in the game. I will consider three possible outcomes - the lowest payoff, Nash Equilibria strategies and socially optimal behavior, concentrating on the latter one. While analyzing the socially optimal behavior, I will construct a mathematical model first, then solve it computationally and finally apply regression analysis tools to derive a generic solution. At the end, I will summarize the paper.

2. THE GAME

The game [Ngo and Smith (2016)] occurs among groups of 4 people and consists of 10 periods. Each period has two stages: an investment stage and a contribution stage. At the start of every period, all players receive endowments of 10.

2.1 Investment Stage

This game incorporates endogenous determination of contribution productivity and dynamic links between periods. These two aspects are incorporated through the investment stage of each period where players have the opportunity to increase their contribution productivity from the starting value of 0.30 (the low used by [Isaac and Walker (1988)]). First, players vote to determine the amount each player in the group will invest in increasing contribution productivity by choosing a whole number between zero and ten, inclusive. A median voter rule is applied and the group's investment is the average of the two middle votes. Then, contribution productivity increases by 0.01 multiplied by the investment. For example, in the first period where contribution productivity equals 0.30, if players vote 1, 3, 5, and 6, the investment will be 4. Therefore, all four group members invest 4 and have a remaining amount of 6 left after the investment. Contribution productivity then equals 0.34. Players vote on an investment and invest in contribution productivity every period, and the amount builds throughout the ten periods.

$$\text{Contribution productivity: } M_t = M_{t-1} + 0.01 \cdot I_t$$
$$\text{for } t = [1..10]$$
$$M_0 = 0.3$$

2.2 Contribution Stage

Following the investment stage is the contribution stage where players decide how to allocate their remaining money between private consumption and public good, similar to a standard public good game. If the investment had been 10, then the players must contribute zero to the public good because they have no money left in the period. The sum of the group members' contributions is multiplied by the new M_t each period and this amount, in addition to any money the player has remaining after the investment and contribution stage, is the player's payoff for that period (note that every player benefits from the sum of the group contributions multiplied by the M_t regardless of whether or not they contribute). Thus, each player's payoff for each period is:

$$\pi_{it} = \omega - I_t - c_{it} + M_t \sum c_{jt}$$

where:

- π_i is the individual's payoff for the period
- ω is the individual's endowment
- I is the investment for the period
- c_i is the individual's contribution to the public good
- M is the contribution productivity
- c_j is the other members' contributions to the public good
- t is the period

Here is an example ($M_0 = 0.3$):

Players	ω	I_t	M_t	C_{it}	$M_t \sum c_{jt}$	π_{it}
1	10			7		4.95
2	10	3	0.33	5	4.95	6.95
3	10			3		8.95
4	10			0		11.95

In this case, the players' endowments are 10. They collectively decide to invest 3. Their multiplier gets increased by $0.01 \cdot 3 = 0.03$ and is equal to 0.33. Players individually decide to contribute 7 (all that is left), 5, 3 and nothing. The payoffs are 4.95, 6.95, 8.95 and 11.95.

The player 4 is a clear example of a free rider. This player did not contribute anything relying on other's contributions, yet still got a benefit from public good. Although this behavior is legitimate in the game, it is clearly not socially optimal.

3. POTENTIAL OUTCOMES

In this section, I will analyze three potential outcomes of the game. The most straightforward scenario is the one where a team gets the lowest possible payoff. The next part is a set of equilibrium scenarios in which each player acts in his own interest in light of what everyone else is doing. In this case, a player has some beliefs about other players' strategies and acts accordingly to maximize his payoff. Finally, I will analyze a scenario where players maximize
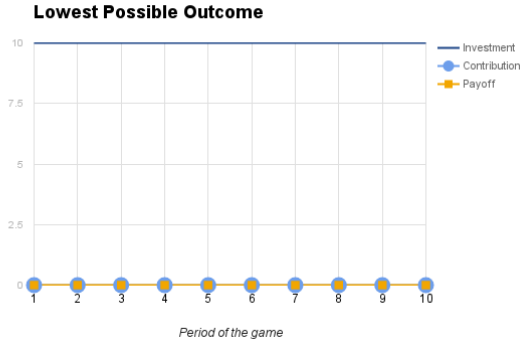
Fig. 1. Lowest possible payoff

Fig. 2. Highest possible equilibrium payoff

the team's payoff. This is a socially optimal behavior where players act in the team's interests, not their own. In each of these scenarios, I will identify the team's strategy and the payoff a team can get.

3.1 Lowest payoff outcome

The lowest payoff one could get is 0. This occurs if the group invests everything in every period and never contributes anything. Payoffs are 0 in every period and 0 at the end of 10 periods.

The reason this outcome is poor is because the investment is never productively used. Investments are meaningless without contributions, because the purpose of investments is to amplify contributions to achieve higher returns. See Figure 1.

3.2 Nash equilibrium

The formal definition of Nash Equilibrium as defined by John Nash is the following:

> *Equilibrium point is n-tuple strategy such that each player's mixed strategy maximizes his pay-off if the strategies of the others are held fixed. Thus, each player's strategy is optimal against those of the others.* [John Nash (1951)]

A less formal definition is given by Robert Gibbons:

> *The collection of strategies in which each player's predicted strategy must be that player's best response to the predicted strategies of the other players.* [Robert Gibbons (1997)]

My goal for the set of equilibrium scenarios is to find each player's strategy such that the player acts in his own interests in light of what other players are doing. Since the game is symmetric (each player starts the game in the same conditions), the players will share the same strategy.

General strategy   According to the definition of Nash equilibrium, each player will aim to maximize his payoff. During the contribution stage the optimal actions are:

$$c_{it} \begin{cases} = 0 & \text{if } M_t < 1 \\ \in [0, \omega - I_t] & \text{if } M_t = 1 \\ = \omega - I_t & \text{if } M_t > 1 \end{cases}$$
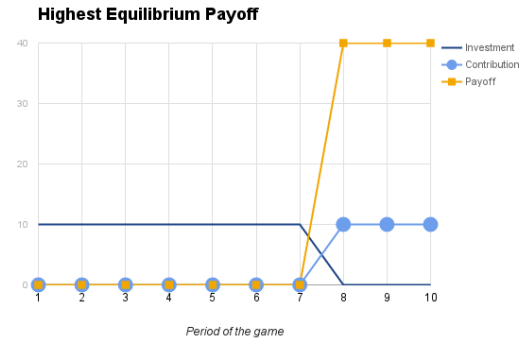
To paraphrase, in equilibrium, each player's individual strategy during the contribution stage is to contribute nothing if the multiplier is below 1, contribute any amount if the multiplier is equal to 1, or contribute everything the player has if the multiplier is higher than 1. Please note that when $M = 1$, any contribution will lead to the same payoff.

These actions are optimal because when $M < 1$ a player's payoff will be less than the value he contributed, if no one else contributed. The player will be worse off if he contributes while others do not (or "free ride"). Therefore, acting in his own interest, he does not contribute. When $M \geq 1$ a player's payoff will be larger or equal to the value he contributed, so he contributes all he has regardless of other players' actions.

During the investment stage, however, any decision will satisfy equilibrium strategy since regardless of the voting, all players make the same investment. For example, if players vote 1, 3, 5 and 7, a median voter rule will produce 4 and *all players* will invest 4. Since all players make the same investment, no player can be in a beneficial position relative to other players at the end of the investment stage. Therefore, any investment decision will lead to an equilibrium. Since a player may make any investment, there are an infinite [1] number of equilibrium solutions.

Special cases   Although there are an infinite number of solutions to the equilibrium scenarios, I identified three special cases. Notice that in equilibrium scenarios all players get the same payoff.

The highest payoff a player can get is 120. This occurs if players invest everything until the 8th period when $M = 1$. Starting from the period 8 and until the end of the game, players contribute their full endowments $\omega = 10$. Each period their payoff is $1 \cdot 4 \cdot 10 = 40$ and at the end they get $3 \cdot 40 = 120$. See Figure 2.

If players decide to invest nothing in all periods, they will keep their endowments and get $10 \cdot 10 = 100$. See Figure 3.

The lowest amount a player can get is 30. This occurs if players build the multiplier equal to 1, and afterwards do not contribute. It will take 7 periods to build such

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[1] If we restrict the smallest possible amount of investment - for example to $0.01 - then there will be a finite number of solutions.
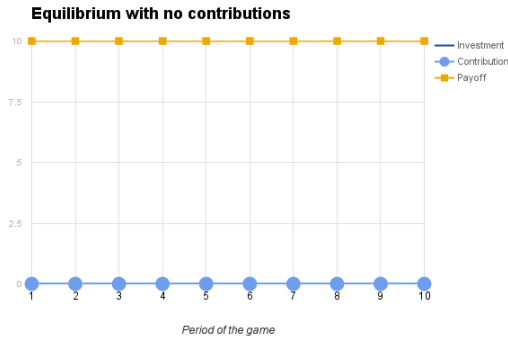
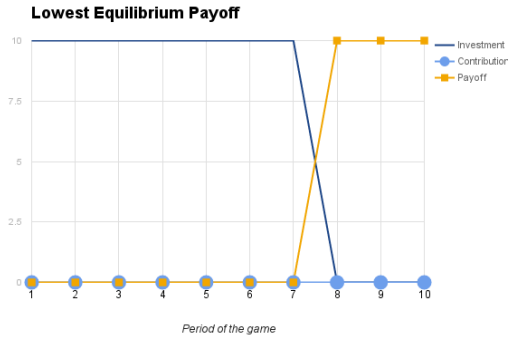Fig. 3. Equilibrium payoff with no investments and no contributions

Fig. 4. Lowest possible equilibrium payoff

multiplier. Players will keep their endowments last 3 periods and will get $3 \cdot 10 = 30$. See Figure 4.

$$\begin{cases} I_t = 10 & \text{for } t \in [1, 7] \\ c_{it} = 0 & \text{for } \forall i \forall t \end{cases}$$

Notice that an individual player cannot affect such scenario - if the other three players vote the same amount to invest, that amount gets invested.

3.3 Socially optimal behavior

The mathematical model   To approach this problem I have to build a mathematical model. Thinking of a single period I can define a function f of investment I and contribution C that returns a payoff. Let me define this function for the period after the t_{th} period.

$$f(I, C) = [M_t \cdot 4 \cdot C] + [\omega - C - I]$$
$$M_t = M_{t-1} \cdot (1 + 0.01 \cdot I)$$
$$M_0 = 0.3$$

$M_t \cdot 4 \cdot C$ is payoff and $\omega - C - I$ is the amount left after both stages.

Since every \$1 contributed will give at least $0.3 \cdot 4 = \$1.2$ back, keeping money in the contribution is not socially optimal and I can state an assumption:

> *The optimal result requires contributing all that is left after the investment.*

Now, the term $\omega - C - I$ equals 0, so I see that $I = \omega - C$, which means that I can eliminate one of the two variables - C or I. Let me instead introduce a new variable p as a fraction of endowment which player invests.

Now $I = p \cdot \omega$ and $C = (1 - p) \cdot \omega$. Let me redefine the function:

$$f(p) = M_t \cdot 4 \cdot \omega \cdot (1 - p)$$
$$M_t = M_{t-1} \cdot (1 + 0.01 \cdot \omega \cdot p)$$
$$M_0 = 0.3$$

where:

- p is the *proportion* of investment
- ω is the endowment (10)
- M_t is the t_{th} multiplier

From now, let me solve it specifically for my case, when endowment is 10.

$$f(p) = 40 \cdot M_t \cdot (1 - p)$$
$$M_t = M_{t-1} \cdot (1 + \frac{p}{10})$$
$$M_0 = 0.3$$

where:

- p is the *proportion* of investment
- M_t is the t_{th} multiplier

This is a recursive function that is difficult to solve analytically.

The computational model   Having the mathematical model, I can make use of a computer to solve it numerically, and then use regression analysis to derive the analytical solution.

First, let me approximate how much time it would take for the computer to execute this simulation.

If I ran the simulation for 10 periods with a step p that is at least as small as 0.1, the time complexity of the algorithm would be $O(n^a)$, which is $\approx 10^{10} \cdot c$ computations. It would take months to run the simulation on a usual PC, so I need to improve the formula.

Let me make the second assumption:

> *The optimal solution requires that players first only invest then only contribute. In other words, $p = 1.0$ for some number of periods, then $p \in [0.0, 1.0]$ for one period, and finally $p = 0.0$ for the rest of the game.*

This assumption is based on the fact that the value of an investment declines and the value of a contribution grows with time.

This assumption reduces the complexity of the algorithm to linear - $O(n)$.

Let me define two functions (see Appendix A) that compute payoff for each possible p. This program runs the game 10 periods for all possible values of p taking into account the second assumption. For each such run it returns a payoff. The result of the computation is in the Appendix B.
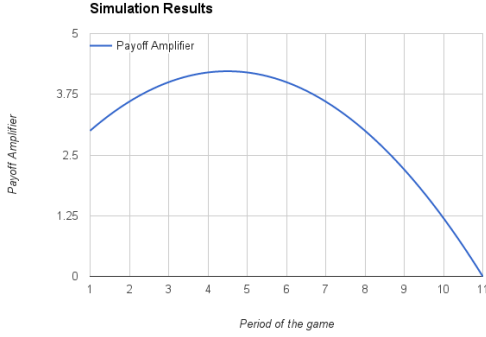
Fig. 5. Function of payoff depending on time when a player switches to contribution - $f(p)$

Although this simulation immediately gives me the value of p where payoff is maximized, I am interested in a generic solution. Let me plot the function. According to the Figure 5, the resulting function has a global maximum and is probably quadratic with $a < 0$.

Regression Analysis   The last step is to try to "estimate" the formula for the data. I enter the data in the regression tool (http://www.xuru.org/rt/pr.asp), give it a potential mathematical model (in my case it is a quadratic formula $ax^2 + bx + c$) and run it. The tool would estimate the formula with numeric coefficients and error value. In this case, I got a quadratic formula with the error value equal to 0 which means perfect fit. Now, let me derive a generic formula so that it fits numeric one. This is an artistic process - I play around with numbers trying to compose variables such that they fit the quadratic formula.

$$f(x) = 400 \cdot \left[-m \cdot \omega \cdot x^2 + (m \cdot \omega \cdot T - M_0) \cdot x + M_0 \cdot T \right]$$
$$x_{\max} = \frac{T}{2} - \frac{M_0}{2 \cdot m \cdot \omega}$$
$$f_{\max} = f(x_{\max}) = f\left(\frac{T}{2} - \frac{M_0}{2 \cdot m \cdot \omega} \right)$$

where:

- m is the increase in multiplier (0.01)
- T is the number of periods
- x is the stage when players switch to contributing. The number before the decimal point defines a period. The number after the decimal point defines an investment in that period.

The computation and regression analysis were conducted for different values of m, ω, M_t, T and x to demonstrate the robustness of the formula.

As a final step, with a generic formula I can compute the actual outcome by using my specific initial values.

$$f(x) = -0.1x^2 + 0.7x + 3$$
$$x_{\text{optimal}} = 3.5$$

which indicates investment until the 4_{th} period and in that period investment of 0.5
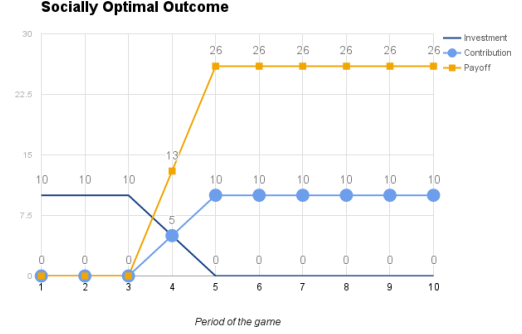

Fig. 6. Socially optimal outcome payoff

$$f_{\text{optimal}} = f(x_{\text{optimal}}) = 169$$

which implies the payoff of 169.

The maximum payoff for each player in the group of 4 is 169. To achieve this, the players must invest everything until period 4, then invest half of their endowments, and contribute everything afterwards. See Figure 6.

4. CONCLUSION

In this paper I have analyzed three potential outcomes of the game. The lowest possible outcome occurs if players only invest and never contribute. A player's payoff is 0 since it is unreasonable to invest in contribution multiplier and not to contribute. The equilibrium strategies occur if all players contribute all or nothing depending on the contribution productivity. Finally, I have analyzed the socially optimal outcome. It occurs if players invest until a certain period, then only contribute. I have analytically derived a generic formula that produces the optimal strategy.

5. ACKNOWLEDGEMENTS

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Appendix A. COMPUTATIONAL SOLUTION CODE

Appendix B. COMPUTATIONAL RESULTS