Stationary social learning in a changing environment

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Introduction

- Social learning literature:
  - two sources of information: private and social learning,
  - permanent state
- Changing state
  - natural assumption in many settings
  - rare and rapid political transitions: Arab Spring, 1830 liberal revolutions, carnival of Solidarity August 1980 - December 1981
- Why changing state matters?
  - Grossman-Stiglitz paradox makes stopping learning (i.e., informational cascade) not possible.

Question	Result
learning efficiency + welfare	no asymptotic learning, even with slowly changing state
is more social learning better?	it can be worse
behavior and beliefs	uniformity under slowly changing state, rare, rapid transitions

- Most striking results are when state is (very) persistent, but not permanent.
- Related lit: Moscarini Ottaviani Smith (98), Dasaratha Golub Hak (20), Kabos Meyer (21)

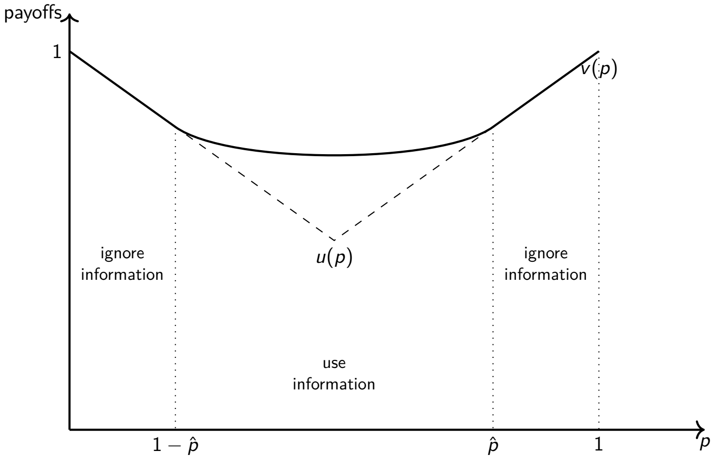
Model

- Markov-changing state $\theta_t \in \{0, 1\}$.
  - $\lambda = P(\theta_{t+1} \neq \theta | \theta_t = \theta)$,
  - neither independent ($\lambda = \frac{1}{2}$), nor permanent ($\lambda = 0$),
  - slow transitions ($\lambda \to 0$)
- Social learning: in each period, continuum of short-lived agents
  - random sample of n actions from the previous period(s),
  - private signal at cost $c \geq 0$,
  - action $a \in \{0, 1\}$,
  - utility $u(a, \theta_t) = \mathbf{1}(a = \theta_t)$.
- Stationary equilibrium $\mu \in \Delta(X \times \{0, 1\})$, where
  - $x \in X = [0, 1]$ if the fraction of population playing 1.

Model

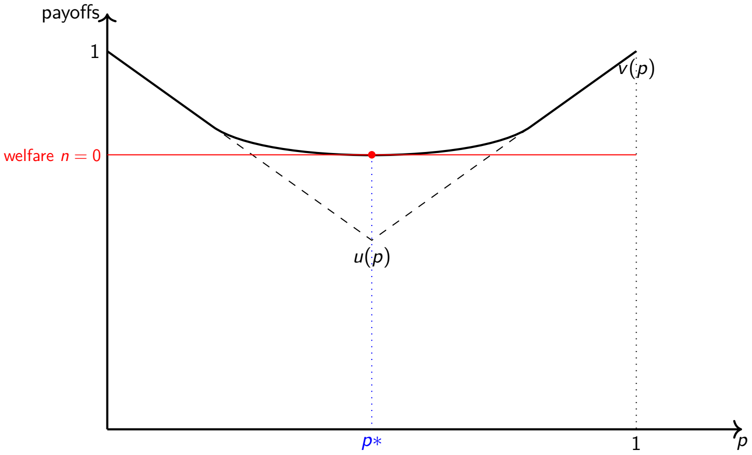
- Assumption: private signal is
  - either costly $c > 0$, or
  - free but with bounded precision,
- p - private belief about the state
  - $u(p)$ - expected payoff from optimal action
  - $v(p) \geq u(p)$ - expected payoff from optimally using information and then taking action

Model



- Assumption implies that $v(p) = u(p)$ for extreme beliefs.

Welfare $n = 0$



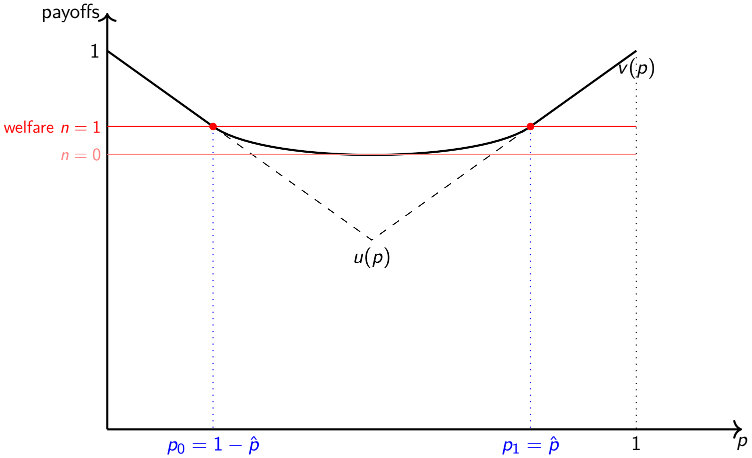
- each generation is identical and can only learn from private signal

Welfare

Permanent state

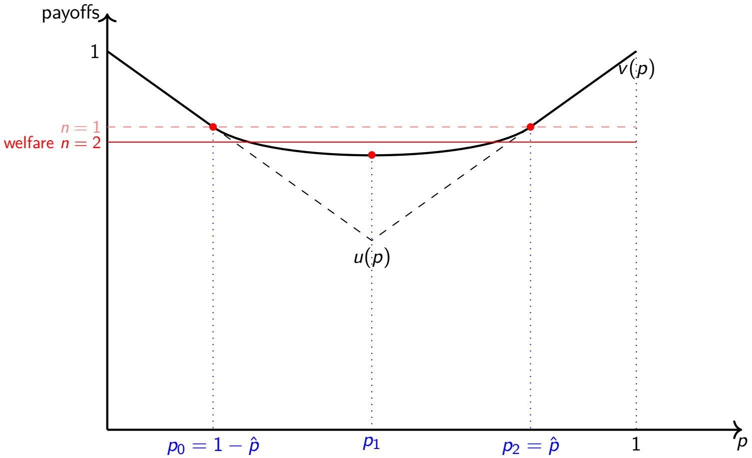
- Permanent state ($\lambda = 0$)
  - $n = 0$: no social learning
  - $n = 1$: some social learning but herding (Banerjee 92, Bikchandani et al 92)
  - $n = 2$: asymptotic full learning (Banerjee Fudenberg 2004)
- If state is permanent, social learning helps!

Welfare $n = 1$



- $p_0, p_1 \in [1 - \hat{p}, \hat{p}]$ and if $\lambda \leq \lambda^*$, then $p_1 = \hat{p} = 1 - p_0$.
  - p_k - belief after observing k agents (out of n sample) playing 1.

Welfare $n = 2$



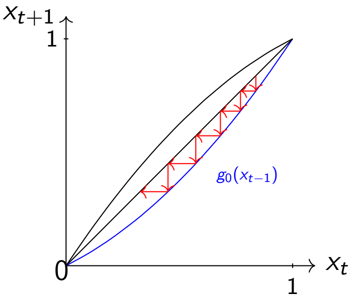
- **Theorem**: $p_0, p_1, p_2 \in [1 - \hat{p}, \hat{p}]$ and if $\lambda \leq \lambda^*$, then $p_2 = \hat{p} = 1 - p_0$.

Welfare $n = 2$

Proof sketch

- Suppose $p_2 > \hat{p}$: non-confused agents *don't* buy information.
  - ϕ_θ the probability that an agent with interim beliefs $p_1 = \frac{1}{2}$ (who thus acquires info) plays action 1 in state θ.
  - x_t the fraction of agents playing action 1 at date t

$$x_{t+1} = x_t^2 + 2x_t(1 - x_t)\phi_{\theta_{t+1}} =: g_{\theta_t}(x_t).$$



Welfare $n = 2$

Proof sketch

$$x_{t+1} = x_t^2 + 2x_t(1 - x_t)\phi_{\theta_{t+1}} =: g_{\theta_t}(x_t) .$$

- Sooner or later, x_t will be close to 0.
- Around 0,

$$\ln x_{t+1} \simeq \ln x_t + \ln 2\phi_{\theta_{t+1}}$$

  : 'random walk' with drift.
  - Since $4\phi_1(1 - \phi_1) < 1, \ln 2\phi_1 < -\ln 2\phi_0$: the drift is negative.

  $\Rightarrow$ $\lim x_t \in \{0, 1\}$, a.s.

  $\Rightarrow$ Samples are uninformative

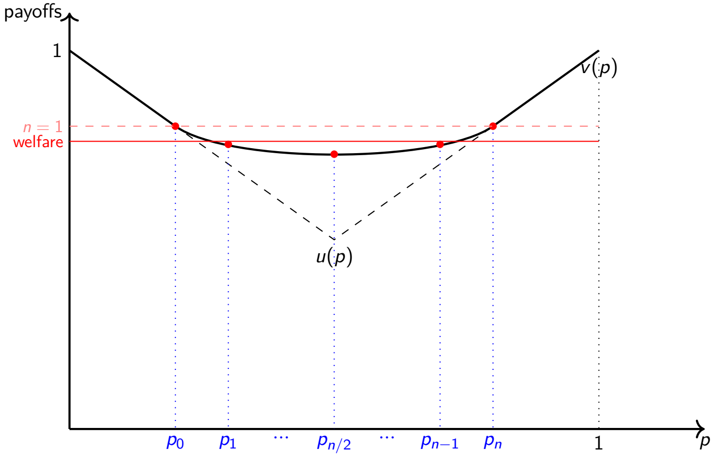
Welfare $n \geq 2$

- For $n > 2$, we need some assumptions:
  - persistent (but not permanent) state: $\lambda \to 0$
  - precise signals: $n^2 \phi_1 (1 - \phi_1) < 1$,
    - example: perfect signals
  - regular equilibrium: $p_{n-1} \geq \frac{1}{2}$.

Theorem

Under the above assumptions, in equilibrium, $\lim_{\lambda \to 0} p_n^\lambda = \hat{p} = 1 - \lim p_0^\lambda$.

Welfare $n \geq 2$



Behavior: Consensus

- Let $\mu_\lambda \in \Delta\left(X \times \{0,1\}\right)$ be the stationary equilibrium.

Theorem

If $n \geq 2$, then, for each $\varepsilon > 0$

$$\lim_{\lambda \to 0} \mu_\lambda \left\{\varepsilon \leq x \leq 1-\varepsilon\right\} = 0.$$

- uniform behavior, most of the time,
- together with previous result, uniform beliefs

Behavior: Consensus

Proof sketch

- Each agent observes random sample $(a_1, ..., a_n)$
  - a_1 is λ-close to optimal action,
  - a_2 cannot add too much information if λ is small,

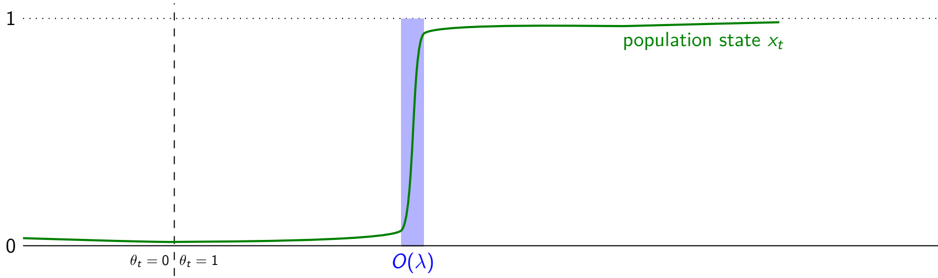
  $\Rightarrow$ $a_1 = a_2$, most likely.

Theorem

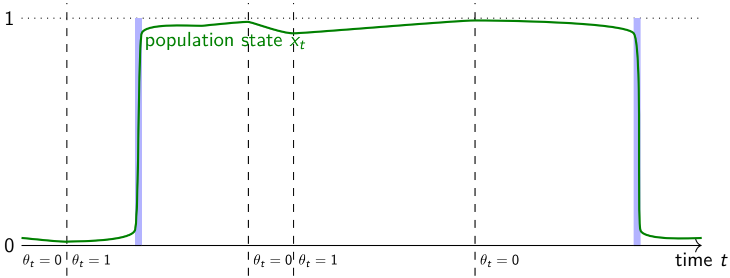
There exists a constant $K < \infty$ such that

$$\int x(1-x)\, d\mu^{\lambda}(x,\theta) \leq K\lambda.$$

Behavior: Rapid transitions

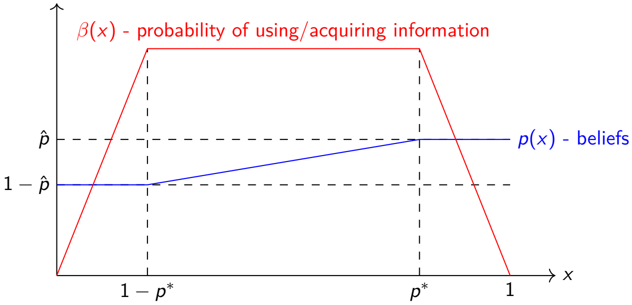


Behavior: Rapid transitions



Comments: $n \to \infty$

- Continuum time version <- we can compute equilibria.
- Binary signals



Comments: continuum actions

- Suppose $n \geq 2$, and
  - $A = [0,1]$ and $u(a,\theta) = -(a-\theta)^2$,
  - perfect signals
- With permanent state ($\lambda = 0$) -> asymptotic learning and welfare $=$ 1.
- With persistent state ($\lambda > 0$) -> there are stationary equilibria with welfare <1.

Conclusions

- Social learning with changing state
- Even when state is very persistent (but not permanent):
  - no asymptotic learning, uniformly bounded welfare
- Additionally, when state is persistent
  - behavior and beliefs exhibit consensus,
  - rare and rapid transitions.