

# micro Hayekian Market

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# Introduction to a micro Hayekian Market

The purpose of this note is that of showing a very simple agent-based model of a market, with emergent interesting price dynamics. A counter example is also introduced, showing implausible price dynamics.

The code uses the IPython language (interactive Python) and can be downloaded from <https://github.com/terna/microHayekianMarket> using the *Clone or download* button; it is also possible to run it directly on line at <https://mybinder.org/v2/gh/terna/microHayekianMarket/master?filepath=microHayekianMarket.ipynb>.

A suggested reading about Hayek is a quite recent paper of Bowles *et al.* (2017).

## 1 The structure of the model and the *warming up* phase

Our agents are simply prices, to be interpreted as reservation prices:<sup>1</sup>

We have two price vectors:  $pL^b$  with item  $pL_i^b$  for the buyers, and  $pL^s$  with item  $pL_j^s$  for the sellers. The  $i^{th}$  or the  $j^{th}$  elements of the vectors are prices, but in this case we can use them also as agents.

Both in the hayekian perspective (Section 2) and in the unstructured one (Section 3) we have a common *warming up* action.

In this phase we define:

- $nCycles$  - number of simulation cycles;
- $nBuyers$  - number of the buyers;
- $nSellers$  - number of the sellers;

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<sup>1</sup>The *max* price a buyer could pay and the *min* one a seller could accept.

- $d_0$  - the lower bound for random uniform numbers, both for the buyers and the sellers in the warming up phase; in the running phase, the lower bound is 0;
- $d_1$  - the upper bound for random uniform numbers for the buyers;
- $d_2$  - the upper bound for random uniform numbers for the sellers;
- the initial buyer  $i$  reservation price, different for each buyer:  $p_{b,i} = \frac{1}{1+u_i}$  with  $u_i \sim \mathcal{U}(d_0, d_1)$ ;
- initial seller  $j$  reservation price, different for each seller:  $p_{s,j} = 1 + u_j$  with  $u_j \sim \mathcal{U}(d_0, d_2)$ .

With  $d_0 = 0.1$ ,  $d_1 = 0.2$ ,  $d_2 = 0.2$  and sorting in decreasing order the vector  $pL^b$  and in increasing order the vector  $pL^s$  we obtain two not overlapping price sequences that we can interpret as a demand and an offer curves (Fig. 1).

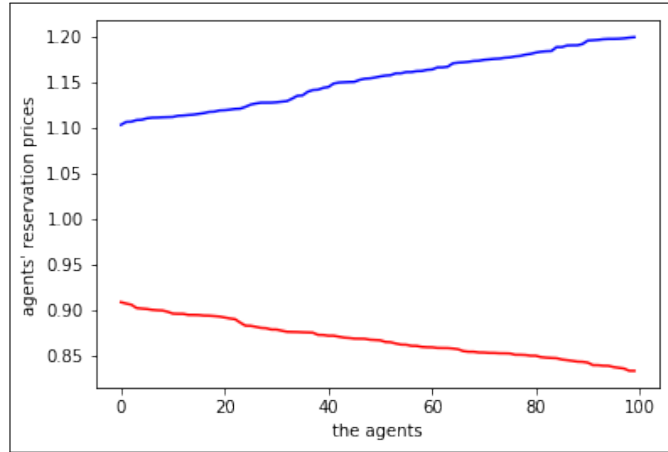


Figure 1: An example of initial not overlapping demand and offer curves

This is the *warming up*, or starting situation, of the model. To generate new examples related to Section 2 and to Section 3, it is necessary to repeat this phase.

## 2 The hayekian version

The buyers and the sellers meet randomly. Buyer  $i$  and seller  $j$  exchange if  $pL_i^b \geq pL_j^s$ ; the deal is recorded at the price of the seller  $pL_j^s$ .<sup>2</sup>

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<sup>2</sup>In the *mall* sell price are public.

In this version, which is the important one in this note, the running prices are changing following the correction coefficients:

- for the buyer: (i)  $c_b = \frac{1}{1+u_b}$  if the deal succeeds (trying the pay less next time) or (ii)  $c_b = 1 + u_b$  if the deal fails (preparing to pay more next time); in (i) and (ii) we have  $u_b \sim \mathcal{U}(0, d_1)$
- for the seller: (iii)  $c_s = \frac{1}{1+u_s}$  if the deal succeeds (preparing to obtain a higher revenue next time) or (iv)  $c_s = 1 + u_s$  if the deal fails (preparing to obtain a lower revenue next time); in (iii) and (iv) we have  $u_s \sim \mathcal{U}(0, d_2)$ .

With  $d_1 = 0.2$ ,  $d_2 = 0.2$  and  $nCycles$  set to 10,000 we obtain sequences of mean prices (mean in each cycle) quite realistic, with a very low variance within each cycle (see Fig. 2 and 3).

The *coefficient of variation* is calculated as  $\frac{\text{standard deviation}}{\text{mean}}$ .

A comment: we have a plausible series of mean price, with a complicated behavior, and with a high stability of the dispersion of the values within each cycle.

The right side of the buyer and seller curves shows another plausible situation with agents not exchanging.

### 3 The unstructured version

The buyers and the sellers meet randomly as in Section 2. Buyer  $i$  and seller  $j$  exchange in any case; the deal is recorded at the mean of the price of the seller  $pL_j^s$  and of the price of the buyer.

In this version the running prices are changing following the correction coefficients:

- with equal probability for the buyer: (i)  $c_b = \frac{1}{1+u_b}$  or (ii)  $c_b = 1 + u_b$ ; in (i) and (ii) we have  $u_b \sim \mathcal{U}(0, d_1)$
- with equal probability for the seller: (iii)  $c_s = \frac{1}{1+u_s}$  or (iv)  $c_s = 1 + u_s$ ; in (iii) and (iv) we have  $u_s \sim \mathcal{U}(0, d_2)$ .

With  $d_1 = 0.2$ ,  $d_2 = 0.2$  and  $nCycles$  set to 10,000 we obtain exploding sequences of mean prices (mean in each cycle), and exploding variance within each cycle (see Fig. 4 and 5).

The *coefficient of variation* is calculated as  $\frac{\text{standard deviation}}{\text{mean}}$ .

A comment: this counter-example shows the missing the intelligent correction of the price that implicitly propagate the price among all the agents, a system of pure random price settings is absolutely far from being plausible.

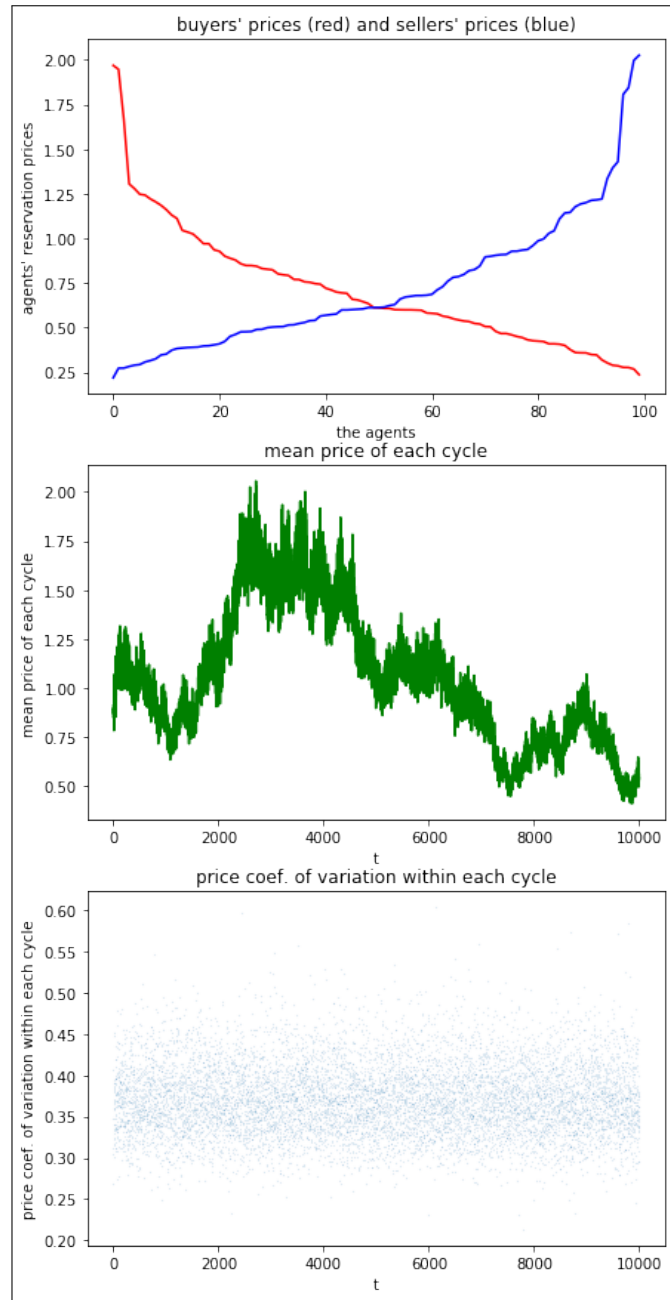


Figure 2: Hayekian case: (i) an example of final demand and offer curves, (ii) the history of mean prices, (iii) their coefficients of variation within each cycle

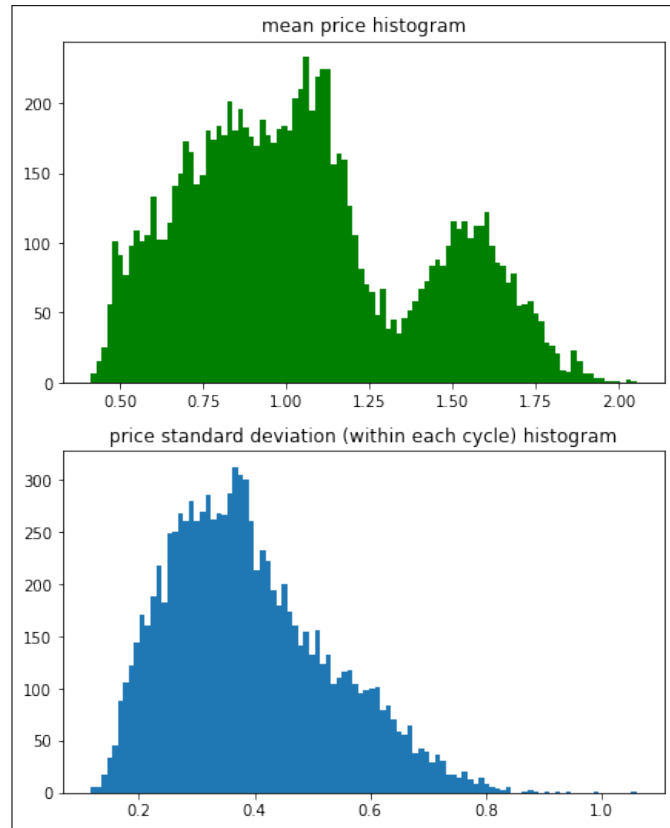


Figure 3: Hayekian case: (i) distribution of mean prices in each cycle and (ii) of their standard deviations



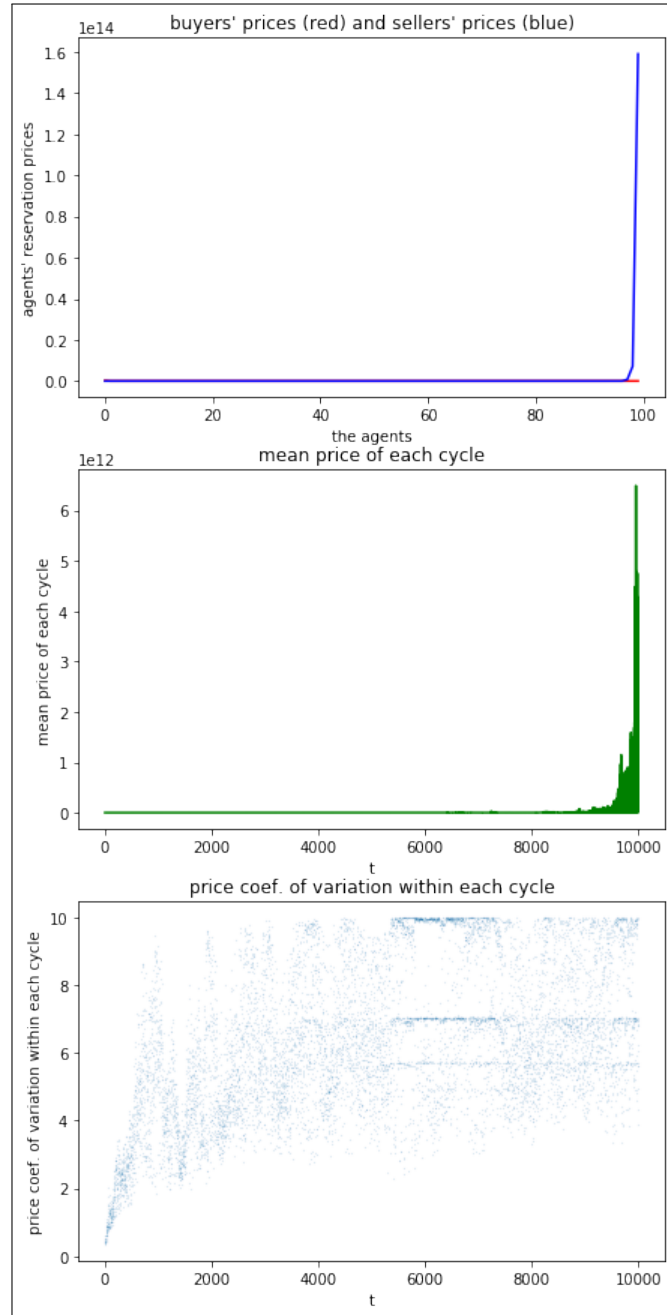


Figure 4: Unstructured case: (i) an example of final demand and offer curves, (ii) the history of mean prices, (iii) their coefficients of variation within each cycle

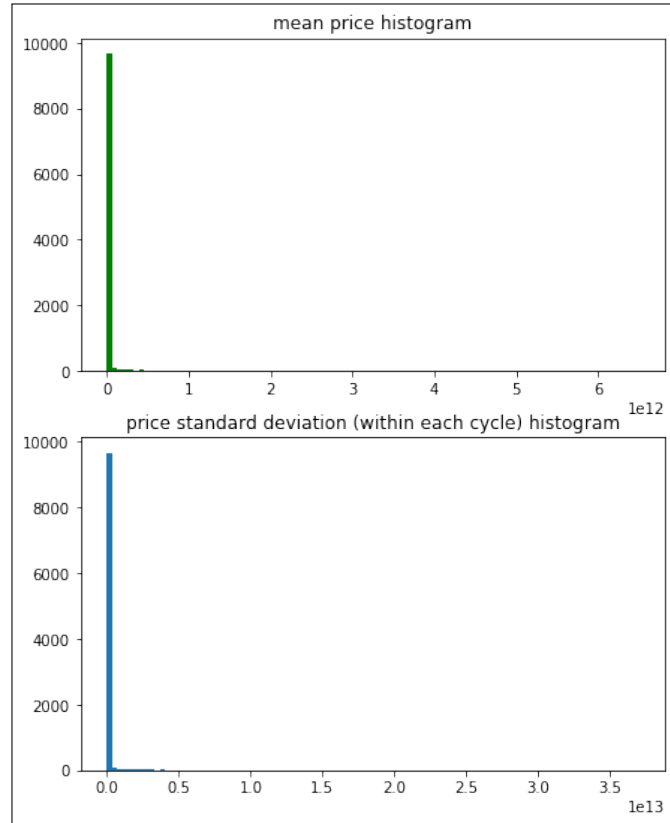


Figure 5: Unstructured case: (i) distribution of mean prices in each cycle and (ii) of their standard deviations

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Bowles, S., Kirman, A. and Sethi, R. (2017). *Retrospectives: Friedrich Hayek and the Market Algorithm*. In «Journal of Economic Perspectives», vol. 31(3), pp. 215-30.

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