

Problem Set 1

1. (Dividing a pie) Two players have £10 to divide between themselves. To do so, they use the following procedure: Each player names a number of pounds (a nonnegative integer), at most equal to 10. If the sum of the two numbers is at most 10 then each player receives the amount of money she names (and the remainder is destroyed). If the sum of the two numbers exceeds 10 and the two numbers are different then the player who names the smaller number receives that amount and the other player receives the remaining money. If the sum of the two numbers exceeds 10 and the two numbers are equal each player receives £5. Determine the best-reply correspondence of each player, plot them in a diagram, and find the Nash equilibria of the game.

2. (Labour market) There are two firms ($i=1,2$) in an industry. Each of them has a job opening. Firm i offers a wage w_i . There are two workers that decide simultaneously to which firm they apply (they can only apply to one). If only one worker applies to a given firm that worker gets the job; if the two workers apply to the same firm, the firm hires one of them randomly and the other remains unemployed (that has payoff zero).

(a) Represent this game in normal form.

(b) Find the pure strategy Nash equilibria (taking into account the different possible values of w_1 and w_2).

(c) Find the mixed strategy Nash equilibria (omit this part if not covered in the lectures).

3. (Political economy) Two people choose whether to become or not a political candidate, and if so which position to take. There is a continuum of citizens, each of whom has a favorite position; the distribution of citizens' favorite positions is given by a uniform density function f on $[0,1]$ with $f(x) = 1$ ($\forall x \in [0,1]$). A candidate attracts the votes of those citizens whose favorite positions are closer to his position than to the position of the other candidate; if the two candidates choose the same position then each receives the fraction $\frac{1}{2}$ of the votes that the position attracts. The winner of the competition is the candidate who receives the most votes. Each person prefers to be the unique winning candidate than tie for the first place, prefers to tie for the first place than to stay out of the competition, and prefers to stay out of the competition than to enter and lose.

(a) Represent (i.e. find the elements) in normal form.

(b) Find the set of pure strategy Nash Equilibria. Hints: can stay out be a strategy in the NE? intuitively, would you place yourself? will they choose different positions?

(c) What would be the equilibrium for a more general probability distribution? (optional)

4. (War of attrition) Two players are involved in a dispute over an object. The value of the object to player i is $v_i > 0$. Time is modeled as a continuous variable that starts at 0 and runs indefinitely. Each player chooses when to concede the object to the other player; if the player to concede does so at time t , the other player obtains the object at that time. If both players concede simultaneously, the object is split equally between them, player i receiving a payoff of $\frac{v_i}{2}$. Time is valuable: until the first concession each player loses one unit of payoff per unit of time.

(a) Represent (i.e. find the elements) in normal form.

(b) Show that in all (pure strategy) Nash equilibria one of the players concedes immediately. Hints: should they concede at the same in equilibrium? can it be that both of them wait? what do you need to ensure that one of them conceding immediately is a NE?

5. (Auctions) An object is to be assigned to a player in the set $\{1, \dots, I\}$ in exchange for a payment. Player i 's valuation of the object is v_i and $v_1 > v_2 > \dots > v_I > 0$. The mechanism used to assign the object is a (sealed-bid) auction: the players simultaneously submit bids (non-negative numbers), and the object is given to the player with the lowest index among those who submit the highest bid, in exchange for payment.

(a) In a first price auction the payment that the winner makes is the price she bids. Formulate a first price auction as a static game and analyze its Nash equilibria. In particular, show that in all equilibria player 1 obtains the object. Hint: can it be otherwise?

(b) In a second price auction the payment that the wins makes is the highest bid among those submitted by the players who do not win (so if only one agent submits the highest bid then the price paid is the second highest bid). Show that in a second price auction the bid v_i of any player i is a weakly dominant strategy.