1 Two person zero sum games

1.1 Introduction: strategic interdependency

In this section we study games with only two players. We also restrict attention to the case where the interests of the players are completely antagonistic: at the end of the game, one player gains some amount, while the other loses the same amount. These games are called “two person zero sum games”.

While in most economics situations the interests of the players are neither in strong conflict nor in complete identity, this specific class of games provides important insights into the notion of "optimal play". In some 2-person zero-sum games, each player has a well defined “optimal” strategy, which does not depend on her adversary decision (strategy choice). In some other games, no such optimal strategy exists. Finally, the founding result of Game Theory, known as the minimax theorem, says that optimal strategies exist when our players can randomize over a finite set of deterministic strategies.

1.2 Two-person zero-sum games in strategic form

A two-person zero-sum game in strategic form is a triple $G = (S, T, u)$, where $S$ is a set of strategies available to the player 1, $T$ is a set of strategies available to the player 2, and $u : S \times T \to \mathbb{R}$ is the payoff function of the game $G$; i.e., $u(s, t)$ is the resulting gain for player 1 and the resulting loss for player 2, if they choose to play $s$ and $t$ respectively. Thus, player 1 tries to maximize $u$, while player 2 tries to minimize it. We call any strategy choice $(s, t)$ an outcome of the game $G$.

When the strategy sets $S$ and $T$ are finite, the game $G$ can be represented by an $n$ by $m$ matrix $A$, where $n = |S|$, $m = |T|$, and $a_{ij} = u(s_i, t_j)$.

The secure utility level for player 1 (the minimal gain he can guarantee himself, no matter what player 2 does) is given by

$$
\overline{m} = \max_{s \in S} \min_{t \in T} u(s, t) = \max_{i} \min_{j} a_{ij}.
$$

A strategy $s^*$ for player 1 is called prudent, if it realizes this secure max-min gain, i.e., if $\min_{t \in T} u(s^*, t) = \overline{m}$.
The secure utility level for player 2 (the maximal loss she can guarantee herself, no matter what player 1 does) is given by

$$\overline{m} = \min_{t \in T} \max_{s \in S} u(s, t) = \min_{j} \max_{i} a_{ij}.$$ 

A strategy $t^*$ for player 2 is called prudent, if it realizes this secure min-max loss, i.e., if $\max_{s \in S} u(s, t^*) = \overline{m}$.

The secure utility level is what a player can get for sure, even if the other player behaves in the worst possible way. For each strategy of a player we calculate what could be his or her worst payoff, resulting from using this strategy (depending on the strategy choice of another player). A prudent strategy is one for which this worst possible result is the best. Thus, by a prudent choice of strategies, player 1 can guarantee that he will gain at least $\overline{m}$, while player 2 can guarantee that she will loose at most $\overline{m}$. Given this, we should expect that $m \leq \overline{m}$.

**Lemma 1** For all two-person zero-sum games, $m \leq \overline{m}$.

**Proof:** $\overline{m} = \max_{s \in S} \min_{t \in T} u(s, t) = \min_{i} \max_{j} a_{ij} \leq \max_{s \in S} u(s, t^*) = m$.

**Definition 2** If $\overline{m} = m$, then $m = \overline{m} = m$ is called the value of the game $G$. If $\overline{m} < m$, we say that $G$ has no value.

An outcome $(s^*, t^*) \in S \times T$ is called a saddle point of the payoff function $u$, if $u(s, t^*) \leq u(s^*, t^*) \leq u(s^*, t)$ for all $s \in S$ and for all $t \in T$.

**Remark 3** Equivalently, we can write that $(s^*, t^*) \in S \times T$ is a saddle point if

$$\max_{s \in S} u(s, t) \leq u(s^*, t^*) \leq \min_{t \in T} u(s^*, t).$$

When the game is represented by a matrix $A$, $(s^*, t^*)$ will be a saddle point, if and only if $a_{s^*t^*}$ is the largest entry in its column and the smallest entry in its row.

A game has a value if and only if it has a saddle point:

**Theorem 4** If the game $G$ has a value $m$, then an outcome $(s^*, t^*)$ is a saddle point if and only if $s^*$ and $t^*$ are prudent. In this case, $u(s^*, t^*) = m$. If $G$ has no value, then it has no saddle point either.

**Proof:**

Suppose that $m = m = \overline{m}$, and $s^*$ and $t^*$ are prudent strategies of players 1 and 2 respectively. Then by the definition of prudent strategies

$$\max_{s \in S} u(s, t^*) = \overline{m} = m = \overline{m} = \min_{t \in T} u(s^*, t).$$

In particular, $u(s^*, t^*) \leq m \leq u(s^*, t^*)$; hence, $u(s^*, t^*) = m$.

Thus, $\max_{s \in S} u(s, t^*) = u(s^*, t^*) = \min_{t \in T} u(s^*, t)$, and so $(s^*, t^*)$ is a saddle point.
Conversely, suppose that \((s^*, t^*)\) is a saddle point of the game, i.e., \(\max u(s, t^*) \leq u(s^*, t^*) \leq \min u(s^*, t)\). Then, in particular, \(\max u(s, t^*) \leq \min u(s^*, t)\).

But by the definition of \(m\) as \(\max \min u(s, t)\) we have \(\min u(s^*, t) \leq m\), and by the definition of \(\overline{m}\) as \(\min \max u(s, t)\) we have \(\max u(s, t^*) \geq \overline{m}\). Hence, using Lemma 1 above, we obtain that \(\min u(s^*, t) \leq m \leq \overline{m} \leq \max u(s, t^*)\).

It follows that \(\overline{m} = \max u(s, t^*) = u(s^*, t^*) = \min u(s^*, t) = m\). Thus, \(G\) has a value \(m = \overline{m} = \underline{m}\), and \(s^*\) and \(t^*\) are prudent strategies.

**Examples:**

- *Matching Pennies* is the simplest game with no value: each player chooses Left or Right; player 1 wins +1 if their choices coincide, loses 1 otherwise.

- The *Noisy Gunfight* is a simple game with a value. The two players walk toward each other, with a single bullet in their gun. Let \(a_i(t), i = 1, 2,\) be the probability that player \(i\) hits player \(j\) if he shoots at time \(t\). At \(t = 0\), they are far apart so \(a_i(0) = 0\); at time \(t = 1\), they are so close that \(a_i(1) = 1\); finally \(a_i\) is a continuous and increasing function of \(t\). When player \(i\) shoots, one of 2 things happens: if \(j\) is hit, \(i\) player wins $1 from \(j\) and the game stops (\(j\) cannot shoot any more); if \(i\) misses, \(j\) hears the shot, and realizes that \(i\) cannot shoot any more so \(j\) waits until \(t = 1\), hits \(i\) for sure and collects $1 from him. Note that the *silent* version of the gunfight model (in the problem set below) has no value.

In a game with a value, prudent strategies are optimal—using them, player 1 can guarantee to get at least \(m\), while player 2 can guarantee to loose at most \(m\).

In order to find a prudent strategy:
- player 1 solves the program \(\max m_1(s)\), where \(m_1(s) = \min_{t \in T} u(s, t)\) (maximize the minimal possible gain);
- player 2 solves the program \(\min m_2(t)\), where \(m_2(t) = \max_{s \in S} u(s, t)\) (minimize the maximal possible loss).

We can always find such strategies when the sets \(S\) and \(T\) are finite.

**Remark 5** (Infinite strategy sets) When \(S\) and \(T\) are compact (i.e. closed and bounded) subsets of \(\mathbb{R}^k\), and \(u\) is a continuous function, prudent strategies always exist, due to the fact that any continuous function, defined on a compact set, reaches on it its maximum and its minimum.

In a game without a value, we cannot deterministically predict the outcome of the game, played by rational players. Each player will try to guess his/her opponent’s strategy choice. Recall matching pennies.

Here are several facts about two-person zero-sum games in normal form.
Lemma 6 (rectangularity property) A two-person zero-sum games in normal form has at most one value, but it can have several saddle points, and each player can have several prudent (and even several optimal) strategies. Moreover, if \((s_1, t_1)\) and \((s_2, t_2)\) are saddle points of the game, then \((s_1, t_2)\) and \((s_1, t_2)\) are also saddle points.

A two-person zero-sum games in normal form is called symmetric if \(S = T\), and \(u(s, t) = -u(t, s)\) for all \(s, t\). When \(S, T\) are finite, symmetric games are those which can be represented by a square matrix \(A\), for which \(a_{ij} = -a_{ji}\) for all \(i, j\) (in particular, \(a_{ii} = 0\) for all \(i\)).

Lemma 7 If a symmetric game has a value then this value is zero. Moreover, if \(s\) is an optimal strategy for one player, then it is also optimal for another one.

1.3 Two-person zero-sum games in extensive form

A game in extensive form models a situation where the outcome depends on the consecutive actions of several involved agents (“players”). There is a precise sequence of individual moves, at each of which one of the players chooses an action from a set of potential possibilities. Among those, there could be chance, or random moves, where the choice is made by some mechanical random device rather than a player (sometimes referred to as “nature” moves).

When a player is to make the move, she is often unaware of the actual choices of other players (including nature), even if they were made earlier. Thus, a player has to choose an action, keeping in mind that she is at one of the several possible actual positions in the game, and she cannot distinguish which one is realized: an example is bridge, or any other card game.

At the end of the game, all players get some payoffs (which we will measure in monetary terms). The payoff to each player depends on the whole vector of individual choices, made by all game participants.

The most convenient representation of such a situation is by a game tree, where to non terminal nodes are attached the name of the player who has the move, and to terminal nodes are attached payoffs for each player. We must also specify what information is available at a player at each node of the tree where she has to move.

A strategy is a full plan to play a game (for a particular player), prepared in advance. It is a complete specification of what move to choose in any potential situation which could arise in the game. One could think about a strategy as a set of instructions that a player who cannot physically participate in the game (but who still wants to be the one who makes all the decisions) gives to her "agent". When the game is actually played, each time the agent is to choose a move, he looks at the instruction and chooses according to it. The representative, thus, does not make any decision himself!

Each player only cares about her final payoff in the game. When the set of all available strategies for each player is well defined, the only relevant information is the profile of final payoffs for each profile of strategies chosen by
the players. Thus to each game in extensive form is attached a reduced game in strategic form. In two-person zero sum games, this reduction is not conceptually problematic, however for more general n-person games, it does not capture the dynamic character of a game in extensive form, and for this we need to develop new equilibrium concepts: see Chapter 5.

In this section we discuss games in extensive form with perfect information.

Examples:

- *Gale’s chomp game:* the player take turns to destroy a $n \times m$ rectangular grid, with the convention that if player $i$ kills entry $(p, q)$, all entries $(p', q')$ such that $(p', q') \geq (p, q)$ are destroyed as well. When a player moves, he must destroy one of the remaining entries. The player who kills entry $(1, 1)$ loses. In this game player 1 who moves first has an optimal strategy that guarantees he wins. This strategy is easy to compute if $n = m$, not so if $n \neq m$.

- *Chess* and Zermelo’s theorem: the game of Chess has three payoffs, $+1, -1, 0$. Although we do which one, one of these 3 numbers is the value of the game, i.e., either Win can guarantee a win, or Black can, or both can secure a draw.

**Definition 8** A finite game in extensive form with perfect information is given by

1) a tree, with a particular node taken as the origin;
2) for each non-terminal node, a specification of who has the move;
3) for each terminal node, a payoff attached to it.

Formally, a tree is a pair $\Gamma = (N, \sigma)$ where $N$ is the finite set of nodes, and $\sigma : N \rightarrow N \cup \emptyset$ associates to each node its predecessor. A (unique) node $n_0$ with no predecessors (i.e., $\sigma(n_0) = \emptyset$) is the origin of the tree. Terminal nodes are those which are not predecessors of any node. Denote by $T(N)$ the set of terminal nodes. For any non-terminal node $r$, the set $\{n \in N : \sigma(n) = r\}$ is the set of successors of $r$. The maximal possible number of edges in a path from the origin to some terminal node is called the length of the tree $\Gamma$.

Given a tree $\Gamma$, a two-person zero-sum game with perfect information is defined by a partition of $N$ as $N = T(N) \cup N_1 \cup N_2$ into three disjoint sets and a payoff function defined over the set of terminal nodes $u : T(N) \rightarrow \mathbb{R}$.

For each non-terminal node $n$, $n \in N_i$ ($i = 1, 2$) means that player $i$ has the move at this node. A move consists of picking a successor to this node. The game starts at the origin $n_0$ of the tree and continues until some terminal node $n_t$ is reached. Then the payoff $u(n_t)$ attached to this node is realized (i.e., player 1 gains $u(n_t)$ and player 2 looses $u(n_t)$).

We do not necessary assume that $n_0 \in N_1$. We even do not assume that if a player $i$ has a move at a node $n$, then it is his or her opponent who moves at its successor nodes (if the same player has a move at a node and some of its successors, we can reduce the game and eliminate this anomaly).
The term “perfect information” refers to the fact that, when a player has to move, he or she is perfectly informed about his or her position in the tree. If chance moves occur later or before this move, their outcome is revealed to every player.

Recall that a strategy for player \( i \) is a complete specification of what move to choose at each and every node from \( N_i \). We denote their set as \( S_i \) or \( T_i \), as above.

**Theorem 9** Every finite two-person zero-sum game in extensive form with perfect information has a value. Each player has at least one optimal (prudent) strategy in such a game.

**Proof:**

The proof is by induction in the length \( l \) of the tree \( \Gamma \). For \( l = 1 \) the theorem holds trivially, since it is a one-person one-move game (say, player 1 is to choose a move at \( n_0 \), and any of his moves leads to a terminal node). Thus, a prudent strategy for the player 1 is a move which gives him the highest payoff, and this payoff is the value of the game.

Assume now that the theorem holds for all games of length at most \( l - 1 \), and consider a game \( G \) of length \( l \). Without loss of generality, \( n_0 \in N_1 \), i.e., player 1 has a move at the origin.

Let \( \{n_1, ..., n_k\} \) be the set of successors of the origin \( n_0 \). Each subtree \( \Gamma_i \) with the origin \( n_i \) is of length \( l - 1 \) at most. Hence, by the induction hypothesis, any subgame \( G_i \) associated with a \( \Gamma_i \) has a value, say, \( m_i \). We claim that the value of the original game \( G \) is \( m = \max_{1 \leq i \leq k} m_i \).

Indeed, by moving first to \( n_i \) and then playing optimally at \( G_i \), player 1 can guarantee himself at least \( m_i \). Thus, player 1 can guarantee that he will gain at least \( m \) in our game \( G \). But, by playing optimally in each game \( G_i \), player 2 can guarantee herself the loss of not more than \( m_i \). Hence, player 2 can guarantee that she will lose at most \( m \) in our game \( G \). Thus max-min and min-max payoffs coincide and \( m \) is the value of the game \( G \).

The value of a finite two-person zero-sum game in extensive form, as well as optimal strategies for the players, are easily found by solving the game backward. We start by any non-terminal node \( n \), such that all its successors are terminal. An optimal choice for the player \( i \) who has a move at \( n \) is clearly one which leads to a terminal node with the best payoff for him/her (the max payoff if \( i = 1 \), or the min payoff if \( i = 2 \)). We can write down this optimal move for the player \( i \) at the node \( n \), then delete all subtree which originates at \( n \), except the node \( n \) itself, and finally assign to \( n \) the best payoff player \( i \) can get. Thus, the node \( n \) becomes the terminal node of so reduced game tree. After a finite number of such steps, the original game will reduce to one node \( n_0 \), and the payoff assigned to it will be the value of the initial game. The optimal strategies of the players are given by their optimal moves at each node, which we wrote down when reducing the game.

**Remark 10** Consider the simple case, where all payoffs are either \(+1\) or \(-1\) (a player either “wins” or “looses”), and where whenever a player has a move...
at some node, his/her opponent is the one who has a move at all its successors. An example is Gale’s chomp game above. When we solve this game backward, all payoffs which we attach to non-terminal nodes in this process are +1 or −1 (we can simply write “+” or “−”). Now look at the original game tree with “+” or “−” attached to each of its node according to this procedure. A “+” sign at a node n means that this node (or “this position”) is “winning” <for player 1>, in a sense that if the player 1 would have a move at this node he would surely win, if he would play optimally. A “−” sign at a node n means that this node (or “this position”) is “loosing” <for player 1>, in a sense that if the player 1 would have a move at this node he would surely lose, if his opponent would play optimally. It is easy to see that “winning” nodes are those which have at least one “loosing” successor, while “loosing” nodes are those whose all successors are “winning”. A number of the problems below are about computing the set of winning and losing positions.

1.4 Mixed strategies

Motivating examples:

Matching pennies: the matrix $\begin{pmatrix} 1 & -1 \\ -1 & 1 \end{pmatrix}$, has no saddle point. Moreover, for this game $m = -1$ and $m = 1$ (the worst possible outcomes), i.e., a prudent strategy does not provide any of two players with any minimal guarantee. Here a player’s payoff depends completely on how well he or she can predict the choice of the other player. Thus, the best way to play is to be unpredictable, i.e. to choose a strategy (one of the two available) completely random. It is easy to see that if each player chooses either strategy with probability 1/2 according to the realization of some random device (and so without any predictable pattern), then “on average” (after playing this game many times) they both will get zero. In other words, under such strategy choice the “expected payoff” for each player will be zero. Moreover, we show below that this randomized strategy is also optimal in the mixed extension of the deterministic game.

Bluffing in Poker When optimal play involves some bluffing, the bluffing behavior needs to be unpredictable. This can be guaranteed by delegating a choice of when to bluff to some (carefully chosen!) random device. Then even the player herself would not be able to predict in advance when she will be bluffing. So the opponents will certainly not be able to guess whether she is bluffing. See the bluffing game (problem 17) below.

Schelling’s toy safe. Ann has 2 safes, one at her office which is hard to crack, another "toy" fake at home which any thief can open with a coat-hanger (as in the movies). She must keep her necklace, worth $10,000, eithe at home or at the office. Bob must decide which safe to visit (he has only one visit at only one safe). If he chooses to visit the office, he has a 20% chance of opening the safe. If he goes to ann’s home, he is sure to be able to open the safe. The point of this example is that the presence of the toy safe helps Ann, who should actually use it to hide the necklace with a positive probability.

Even when using mixed strategies is clearly warranted, it remains to deter-
mine which mixed strategy to choose (how often to bluff, and on what hands?). The player should choose the probabilities of each deterministic choice (i.e. on how she would like to program the random device she uses). Since the player herself cannot predict the actual move she will make during the game, the payoff she will get is uncertain. For example, a player may decide that she will use one strategy with probability $\frac{1}{3}$, another one with probability $\frac{1}{6}$, and yet another one with probability $\frac{1}{2}$. When the time to make her move in the game comes, this player would need some random device to determine her final strategy choice, according to the pre-selected probabilities. In our example, such device should have three outcomes, corresponding to three potential choices, relative chances of these outcomes being $2:1:3$. If this game is played many times, the player should expect that she will play 1-st strategy roughly $\frac{1}{3}$ of the time, 2-nd one roughly $\frac{1}{6}$ of the time, and 3-d one roughly $\frac{1}{2}$ of the time. She will then get “on average” $\frac{1}{3}$ (of payoff if using 1-st strategy) $+\frac{1}{6}$ (of payoff if using 2-nd strategy) $+\frac{1}{2}$ (of payoff if using 3-d strategy).

Note that, though this player’s opponent cannot predict what her actual move would be, he can still evaluate relative chances of each choice, and this will affect his decision. Thus a rational opponent will, in general, react differently to different mixed strategies.

What is the rational behavior of our players when payoffs become uncertain? The simplest and most common hypothesis is that they try to maximize their expected (or average) payoff in the game, i.e., they evaluate random payoffs simply by their expected value. Thus the cardinal values of the deterministic payoffs now matter very much, unlike in the previous sections where the ordinal ranking of the outcomes is all that matters to the equilibrium analysis. We give in Chapter 2 some axiomatic justifications for this crucial assumption.

The expected payoff is defined as the weighted sum of all possible payoffs in the game, each payoff being multiplied by the probability that this payoff is realized. In matching pennies, when each player chooses a “mixed strategy” $(0.5, 0.5)$ (meaning that 1-st strategy is chosen with probability 0.5, and 2-nd strategy is chosen with probability 0.5), the chances that the game will end up in each particular square $(i, j)$, i.e., the chances that the 1-st player will play his $i$-th strategy and the 2-nd player will play her $j$-th strategy, are $0.5 \times 0.5 = 0.25$. So the expected payoff for this game under such strategies is $1 \times 0.25 + (-1) \times 0.25 + 1 \times 0.25 + (-1) \times 0.25 = 0$.

Consider a general finite game $G = (S, T, u)$, represented by an $n$ by $m$ matrix $A$, where $n = |S|$, $m = |T|$. The elements of the strategy sets $S$ and $T$ (“sure” strategy choices, which do not involve randomization) are called pure or deterministic strategies. A mixed strategy for the player is a probability distribution over his or her deterministic strategies, i.e. a vector of probabilities for each deterministic strategy which can be chosen during the actual game playing. Thus, the set of all mixed strategies for player 1 is $s = \{(s_1, \ldots, s_n) : \sum_{i=1}^{n} s_i = 1, s_i \geq 0\}$, while for player 2 it is $Y = \{(y_1, \ldots, y_m) : \sum_{i=1}^{m} y_j = 1, y_j \geq 0\}$.

**Claim 11** When player 1 chooses $s \in s$ and player 2 chooses $y \in Y$, the expected
payoff of the game is equal to $s^T Ay$.

**Proof:** $s^T Ay = (s_1, ..., s_n) \left( \begin{array}{ccc} a_{11} & ... & a_{1m} \\ ... & ... & ... \\ a_{n1} & ... & a_{nm} \end{array} \right) \left( \begin{array}{c} y_1 \\ ... \\ y_m \end{array} \right) = \sum_{i=1}^{n} \sum_{j=1}^{m} s_ia_{ij}y_j,$

and each element of this double sum is $s_ia_{ij}y_j = a_{ij}s_iy_j = a_{ij}\times\text{Prob}[1\text{ chooses } i] \times \text{Prob}[2\text{ chooses } j] = a_{ij}\times\text{Prob}[1\text{ chooses } i\text{ and } 2\text{ chooses } j]$. 

We define the secure utility level for player 1<2> (the minimal gain he can guarantee himself, no matter what player 2<1> does) in the same spirit as before. The only change is that it is now the “expected” utility level, and that the strategy sets available to the players are much bigger now: $s$ and $Y$, instead of $S$ and $T$.

Let $v_1(s) = \min_{y \in Y} s^T Ay$ be the minimum payoff player 1 can get if he chooses to play $s$. Then $v_1 = \max_{s \in s} v_1(s) = \max_{s \in s} \min_{y \in Y} s^T Ay$ is the secure utility level for player 1.

Similarly, we define $v_2(y) = \max_{s \in s} s^T Ay$, and $v_2 = \min_{y \in Y} v_2(y) = \min_{y \in Y} \max_{s \in s} s^T Ay$, the secure utility level for player 2.

**Claim 12** The number $s^T Ay$ can be viewed as a weighted average of the expected payoffs for player 1 when he uses $s$ against player 2’s 2 pure strategies (where weights are probabilities that player 2 will use these pure strategies).

**Proof:**

$$s^T Ay = s^T \left( \begin{array}{ccc} a_{11} & ... & a_{1m} \\ ... & ... & ... \\ a_{n1} & ... & a_{nm} \end{array} \right) \left( \begin{array}{c} y_1 \\ ... \\ y_m \end{array} \right) = s^T [y_1A_{1} + ... + y_mA_{m}] =$$

$$= y_1[s^T A_{1}] + ... + y_m[s^T A_{m}] = y_1[s^T Ae^1] + ... + y_m[s^T Ae^m].$$

Here $A_{j}$ is $j$-th column of the matrix $A$, and $e^j = (0, ..., 0, 1, 0, ..., 0)$ is the (m-dimensional) vector, whose all coordinates are zero, except that its $j$-th coordinate is 1, which represents the pure strategy $j$ of player 2. Recall $A_{j} = Ae^j$.

Now, $s^T Ae^j$ is the expected payoff to player 1, when he uses (mixed) strategy $s$ and player 2 uses (pure) strategy $e^j$. Hence, $s^T Ay = \sum_{j=1}^{m} y_j [s^T Ae^j]$ is a weighted average of player 1’s payoffs against pure strategies of player 2 (when player 1 uses strategy $s$). In this weighted sum, weights $y_j$ are equal to the probabilities that player 2 would choose these pure strategies $e^j$.

Given this claim, $v_1(s) = \min_{y \in Y} s^T Ay$, the minimum of $s^T Ay$, will be attained at some pure strategy $j$ (i.e., at some $e^j \in Y$). Indeed, if $s^T Ae^j > v_1(s)$ for all $j$, then we would have $s^T Ay = \sum_{j=1}^{m} y_j [s^T Ae^j] > v_1(s)$ for all $y \in Y$.

Hence, $v_1(s) = \min_{j} s^T A_{j}$, and $v_1 = \max_{s \in s} \min_{j} s^T A_{j}$. Similarly, $v_2(y) = \max_{i} A_{i}y$, where $A_{i}$ is the $i$-th row of the matrix $A$, and $v_2 = \min_{y \in Y} \max_{i} A_{i}y$. 

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As with pure strategies, the secure utility level player 1 can guarantee himself (minimal amount he could gain) cannot exceed the secure utility level player 2 can guarantee herself (maximal amount she could lose): \( v_1 \leq v_2 \). This follows from Lemma 1.

Such prudent mixed strategies \( \pi \) and \( \pi' \) are called maximin strategy (for player 1) and minimax strategy (for player 2) respectively.

**Theorem 13 (The Minimax Theorem)** \( v_1 = v_2 = v \). Thus, if players can use mixed strategies, any game with finite strategy sets has a value.

**Proof.** Let \( n \times m \) matrix \( A \) be the matrix of a two person zero sum game. The set of all mixed strategies for player 1 is \( s = \{(s_1, ..., s_n) : \sum_{i=1}^n s_i = 1, s_i \geq 0\} \), while for player 2 it is \( Y = \{(y_1, ..., y_m) : \sum_{j=1}^m y_j = 1, y_j \geq 0\} \).

Let \( v_1(s) = \min_{y \in Y} s \cdot Ay \) be the smallest payoff player 1 can get if he chooses to play \( s \). Then \( v_1 = \max_{s \in S} v_1(s) = \max_{s \in S} \min_{y \in Y} s \cdot Ay \) is the secure utility level for player 1.

Similarly, we define \( v_2(y) = \max_{s \in S} s \cdot Ay \), and \( v_2 = \min_{y \in Y} v_2(y) = \min_{y \in Y} \max_{s \in S} s \cdot Ay \) is the secure utility level for player 2. We know that \( v_1 \leq v_2 \).

Consider the following closed convex sets in \( \mathbb{R}^n \):

1. \( S = \{z \in \mathbb{R}^n : \text{for some } y \in Y \} \) is a convex set, since \( Ay = y_1 A_1 + ... + y_m A_m \), where \( A_{ij} \) is \( j \)-th column of the matrix \( A \), and hence \( S \) is the set of all convex combinations of columns of \( A \), i.e., the convex hull of the columns of \( A \). Moreover, since it is a convex hull of \( m \) points, \( S \) is a convex polytope in \( \mathbb{R}^n \) with \( m \) vertices (extreme points), and thus it is also closed and bounded.

2. Cones \( K_v = \{z \in \mathbb{R}^n : z_i \leq v \text{ for all } i = 1, ..., n\} \) are obviously convex and closed for any \( v \in \mathbb{R} \). Further, it is easy to see that \( K_v = \{z \in \mathbb{R}^n : s \cdot z \leq v \text{ for all } s \in S\} \).

Geometrically, when \( v \) is very small, the cone \( K_v \) lies far from the bounded set \( S \), and they do not intersect. Thus, they can be separated by a hyperplane. When \( v \) increases, the cone \( K_v \) enlarges in the direction \((1, ..., 1)\), being “below” the set \( S \), until the moment when \( K_v \) will “touch” the set \( S \) for the first time. Hence, \( \pi \), the maximal value of \( v \) for which \( K_v \) still can be separated from \( S \), is reached when the cone \( K_\pi \) first “touches” the set \( S \). Moreover, \( K_\pi \) and \( S \) have at least one common point \( \pi \), at which they “touch”. Let \( \pi \in Y \) be such that \( Ay = \pi \in S \cap K_\pi \).

Assume that \( K_\pi \) and \( S \) are separated by a hyperplane \( H = \{z \in \mathbb{R}^n : \pi \cdot z = c\} \), where \( \sum_{i=1}^n \pi_i = 1 \). It means that \( \pi \cdot z \leq c \) for all \( z \in K_\pi \), \( \pi \cdot z \geq c \) for all \( z \in S \), and hence \( \pi \cdot \pi = c \). Geometrically, since \( K_\pi \) lies “below” the hyperplane \( H \), all coordinates \( \pi_i \) of the vector \( \pi \) must be nonnegative, and thus \( \pi \in S \).

Moreover, since \( K_\pi = \{z \in \mathbb{R}^n : s \cdot z \leq \pi \text{ for all } s \in S\} \), \( \pi \in S \) and \( \pi \in K_\pi \), we obtain that \( c = \pi \cdot \pi \leq \pi \). But since vector \( (\pi, ..., \pi) \in K_\pi \) we also obtain that \( c \geq \pi \cdot (\pi, ..., \pi) = \pi \sum_{i=1}^n \pi_i = \pi \). It follows that \( c = \pi \).
Now, \( v_1 = \max_{s} \min_{y} s \cdot Ay \geq \min_{\pi \in \mathcal{P}} \pi \cdot Ay \geq \pi \) (since \( \pi \cdot z \geq c = \pi \) for all \( z \in S \), i.e. for all \( z = Ay \), where \( y \in Y \)).

Next, \( v_2 = \min_{\pi} \max_{y} \pi \cdot Ay = \max_{s} \min_{y} Ax = \max_{s} \pi \cdot s \leq \pi \) (since \( \pi = Ax \in K_{\pi} \) and since \( z \cdot s \leq \pi \) for all \( s \) and all \( z \in K_{\pi} \), in particular, \( \pi \cdot s \leq \pi \) for all \( s \in s \)).

We obtain that \( v_2 \leq \pi \leq v_1 \). Together with the fact that \( v_1 \leq v_2 \), it gives us \( v_2 = \pi = v_1 \), the desired statement.

Note also, that the maximal value of \( v_1(s) \) is reached at \( \pi \), while the minimal value of \( v_2(y) \) is reached at \( \pi \). Thus, \( \pi \) and \( \pi \) constructed in the proof are optimal strategies for players 1 and 2 respectively.

**Remark 14** When the sets of pure strategies are infinite, mixed strategies can still be defined as probability distributions over these sets, but the existence of a value for the game in mixed strategies is no longer guaranteed. One needs to check for instance that the assumptions of Von Neumann’s Theorem below are satisfied.

### 1.5 Computation of optimal strategies

How can we find the maximin (mixed) strategy \( \pi \), the minimax (mixed) strategy \( \pi \), and the value \( v \) of a given game?

If the game with deterministic strategies (the original game) has a saddle point, then \( v = m \), and the maximin and minimax strategies are deterministic. Finding them amounts to find an entry \( a_{ij} \) of the matrix \( A \) which is both the maximum entry in its column and the minimum entry in its row.

When the original game has no value, the key to computing optimal mixed strategies is to know their supports, namely the set of strategies used with strictly positive probability. Let \( \pi, \pi \) be a pair of optimal strategies, and \( v = \pi^T Ay \). Since for all \( j \) we have that \( \pi^T A e_j \geq \min_{y \in Y} \pi^T Ay = v_1(\pi) = v_1 = v \), it follows that \( v = \pi^T Ay = \sum_{j=1}^{m} \pi^T e_j = \sum_{j=1}^{m} \pi^T A e_j = v \) (since \( \pi \) is a probability vector), and the equality implies \( \pi^T A e_j = \pi^T A e_j = v \) for all \( j \) such that \( y_j \neq 0 \). Thus, player 2 receives her minimax value \( v_2 = v \) by playing against \( \pi \) any pure strategy \( j \) which is used with a positive probability in her minimax strategy \( \pi \) (i.e. any strategy \( j \), such that \( y_j \neq 0 \)).

Similarly, player 1 receives his maximin value \( v_1 = v \) by playing against \( \pi \) any pure strategy \( i \) which is used with a positive probability in his maximin strategy \( \pi \) (i.e. any strategy \( i \), such that \( \pi_i \neq 0 \)). Setting \( S^* = \{ i | \pi_i > 0 \} \) and \( T^* = \{ j | y_j > 0 \} \), we see that \( \pi, \pi \) solve the following system with unknown \( s, y \)

\[
\begin{align*}
    s^T A_j &= v & \text{for all } j \in T^*; A_i y &= v & \text{for all } i \in S^* \\
    \sum_{i=1}^{n} s_i &= 1, s_i &\geq 0, & \sum_{i=1}^{m} y_j &= 1, y_j &\geq 0
\end{align*}
\]

The difficulty is to find the supports \( S^*, T^* \), because there are \( 2^{n+m} \) possible choices, and no systematic way to guess!
However we can often simplify the task of computing the supports of optimal mixed strategies by successively eliminating dominated rows and columns.

**Definition 15** We say that \( i \)-th row of a matrix \( A \) dominates its \( k \)-th row, if \( a_{ij} \geq a_{kj} \) for all \( j \) and \( a_{ij} > a_{kj} \) for at least one \( j \). Similarly, we say that \( j \)-th column of a matrix \( A \) dominates its \( l \)-th column, if \( a_{ij} \geq a_{il} \) for all \( i \) and \( a_{ij} > a_{il} \) for at least one \( i \).

In other words, a pure strategy (represented by a row or a column of \( A \)) dominates another pure strategy if the choice of the first (dominating) strategy is at least as good as the choice of the second (dominated) strategy, and in some cases it is strictly better. A player can always find an optimal mixed strategy using only undominated strategies.

**Proposition 16** If rows \( i_1, ..., i_k \) of a matrix \( A \) are dominated, then player 1 has an optimal strategy \( \pi \) such that \( \pi_{i_1} = ... = \pi_{i_k} = 0 \); moreover, any optimal strategy for the game obtained by removing dominated rows from \( A \) will also be an optimal strategy for the original game. The same is true for dominated columns and player 2.

Given this, we can proceed as follows. Removing dominated rows of \( A \) gives a smaller matrix \( A_1 \). Removing dominated columns of \( A_1 \) leaves us with a yet smaller matrix \( A_2 \). We continue by removing dominated rows of \( A_2 \), etc., until we obtain a matrix which does not contain dominated rows or columns. The optimal strategies and the value for the game with this reduced matrix will still be the optimal strategies and the value for the initial game represented by \( A \). This process is called “iterative elimination of dominated strategies”. See the problems for examples of application of this technique.

### 1.5.1 \( 2 \times 2 \) games

Suppose that \( A = \begin{pmatrix} a_{11} & a_{12} \\ a_{21} & a_{22} \end{pmatrix} \) and this game does not have saddle point. In this case, a pure strategy cannot be optimal for either player (check it!). It follows that optimal strategies \((s_1, s_2)\) and \((y_1, y_2)\) must have all components positive. Let us repeat the argument above for the \( 2 \times 2 \) case.

We have \( v = s^T A y = a_{11}s_1y_1 + a_{12}s_1y_2 + a_{21}s_2y_1 + a_{22}s_2y_2 \), or

\[
    s_1(a_{11}y_1 + a_{12}y_2) + s_2(a_{21}y_1 + a_{22}y_2) = v.
\]

But \( a_{11}y_1 + a_{12}y_2 \leq v \) and \( a_{21}y_1 + a_{22}y_2 \leq v \) (these are the losses of player 2 against 1-st and 2-nd pure strategies of player 1; but since \( y \) is player’s 2 optimal strategy, she cannot lose more then \( v \) in any case). Hence, \( s_1(a_{11}y_1 + a_{12}y_2) + s_2(a_{21}y_1 + a_{22}y_2) \leq s_1v + s_2v = v \).

Since \( s_1 > 0 \) and \( s_2 > 0 \), the equality is only possible when \( a_{11}y_1 + a_{12}y_2 = v \) and \( a_{21}y_1 + a_{22}y_2 = v \).

Similarly, it can be seen that \( a_{11}s_1 + a_{21}s_2 = v \) and \( a_{12}s_1 + a_{22}s_2 = v \).
We also know that $s_1 + s_2 = 1$ and $y_1 + y_2 = 1$.

We thus have the linear system with 6 equations and 5 variables $s_1, s_2, y_1, y_2$ and $v$. Minimax theorem guarantees us that this system has a solution with $s_1, s_2, y_1, y_2 \geq 0$. One of these 6 equations is actually redundant. The system has a unique solution provided the original game has no saddle point. In particular

$$v = \frac{a_{11}a_{22} - a_{12}a_{21}}{a_{11} + a_{22} - a_{12} - a_{21}}$$

### 1.5.2 Symmetric games

The game with matrix $A$ is symmetric if $A = -A^T$ (Exercise: check this). Like in a general 2 person zero-sum game, the value of a symmetric game is zero. Moreover, if $s$ is an optimal strategy for player 1, then it is also optimal for player 2.

### 1.6 Von Neumann’s Theorem

It generalizes the minimax theorem. It follows from the more general Nash Theorem in Chapter 4.

**Theorem 17** The game $(S, T, u)$ has a value and optimal strategies if $S, T$ are convex compact subsets of some euclidian spaces, the payoff function $u$ is continuous on $S \times T$, and for all $s \in S$, all $t \in T$

$$t' \rightarrow u(s, t')$$ is quasi-convex in $t'$; $s' \rightarrow u(s', t)$ is quasi-concave in $s'$

**Example:** Borel’s model of poker.

Each player bids $\$1$, then receives a hand $m_i \in [0, 1]$. Hands are independently and uniformly distributed on $[0, 1]$. Each player observes only his hand. Player 1 moves first, by either folding or bidding an additional $\$5$. If 1 folds, the game is over and player 2 collects the pot. If 1 bids, player 2 can either fold (in which case 1 collects the pot) or bid $\$5$ more to see: then the hands are revealed and the highest one wins the pot.

A strategy of player $i$ can be any mapping from $[0, 1]$ into $\{F, B\}$, however it is enough to consider the following simple threshold strategies $s_i$ : fold whenever $m_i \leq s_i$, bid whenever $m_i > s_i$. Notice that for player 2, actual bidding only occur if player 1 bids before him. Compute the probability $\pi(s_1, s_2)$ that $m_1 > m_2$ given that $s_1 \leq m_1 \leq 1$:

$$\pi(s_1, s_2) = \frac{1 + s_1 - 2s_2}{2(1 - s_2)} \text{ if } s_2 \leq s_1$$

$$= \frac{1 - s_2}{2(1 - s_1)} \text{ if } s_1 \leq s_2$$

from which the payoff function is easily derived:

$$u(s_1, s_2) = -6s_1^2 + 5s_1s_2 + 5s_1 - 5s_2 \text{ if } s_2 \leq s_1$$

$$= -6s_2^2 + 5s_1s_2 + 5s_2 - 5s_1 \text{ if } s_1 \leq s_2$$
\[ = 6s_2^2 - 7s_1s_2 + 5s_1 - 5s_2 \text{ if } s_1 \leq s_2 \]

The Von Neumann theorem applies, and the utility function is continuously differentiable. Thus the saddle point can be found by solving the system
\[ \frac{\partial u}{\partial s_i}(s) = 0, \quad i = 1, 2. \]
This leads to
\[ s_i^* = \left( \frac{5}{7} \right)^2 = 0.51; \quad s_2^* = \frac{5}{7} = 0.71 \]
and the value \(-0.51\): player 2 earns on average 51 cents.

Other examples are in the problems below.

### 1.7 Problems for two person zero-sum games

#### 1.7.1 Pure strategies

**Problem 1. Gale’s roulette**

a) Each wheel has an equal probability to stop on any of its numbers. Player 1 chooses a wheel and spins it. Player 2 chooses one of the 2 remaining wheels (while the wheel chosen by 1 is still spinning), and spins it. The winner is the player whose wheel stops on the higher score. He gets $1 from the loser.

Numbers on wheel #1: 2, 4, 9; on wheel #2: 3, 5, 7; on wheel #3: 1, 6, 8
Find the value and optimal strategies of this game

b) Variant: the winner with a score of \( s \) gets \$\( s \) from the loser.

**Problem 2. Land division game.**

The land consists of 3 contiguous pieces: the unit square with corners (0, 0), (1, 0), (0, 1), (1, 1), the triangle with corners (0, 1), (1, 1), (0, 2), the triangle with corners (1, 0), (1, 1), (2, 1). Player 1 chooses a vertical line \( L \) with 1st coordinate in \([0, 1]\). Player 2 chooses an horizontal line \( M \) with 2d coordinate in \([0, 1]\). Then player 1 gets all the land above \( M \) and to the left of \( L \), as well as the land below \( M \) and to the right of \( L \). Player 2 gets the rest. Both players want to maximize the area of their land. Find the value and optimal strategies.

**Problem 3. Silent gunfight**

Now the duellists cannot hear when the other player shoots. Payoffs are computed in the same way. If \( v \) is the value of the noisy gunfight, show that in the silent version, the values \( \overline{m} = \min \max \) and \( \underline{m} = \max \min \) are such that \( \underline{m} < v < \overline{m} \).

**Problem 4**

Two players move in turn and the one who cannot move loses. Find the winner (1-st or 2-nd player) and the winning strategy.

a) A castle stays on the square a1 of the 8x8 chess board. A move consists in moving the castle according to the chess rules, but only in the directions up or to the right.

b) The same game, but with a knight instead of a castle.

c) A move consists in placing a castle on the 8 by 8 chess board in such a way, that it does not threatens any of the castles already present.

d) The same game, but bishops are to be placed instead of castles.
e) 20 coins are placed on the table in a chain (such that they touch each other), so that they form either a straight line, or a circle. A move consists in taking either one or two adjacent (touching) coins.
f) The game starts with two piles, of respectively 20 and 21 stones. A move consists in taking one pile away and dividing the other into two nonempty piles.
g) The same game, but the two piles are of sizes \( n \) and \( m \).
h) Same rules for moving as in f), but the one who cannot move wins.

**Problem 5**
Ten thousands students formed a square. In each row, the tallest student is chosen and Mary is the shortest one among those. In each column, a shortest student is chosen, and John is the tallest one among those. Who is taller—John or Mary?

**Problem 6**
Compute \( \bar{m} = \min \max \) and \( m = \max \min \) values for the following matrices:

\[
\begin{array}{ccc}
2 & 4 & 6 \\
6 & 2 & 4 \\
4 & 6 & 2 \\
\end{array}
\]

\[
\begin{array}{ccc}
3 & 2 & 2 \\
2 & 3 & 2 \\
2 & 2 & 3 \\
\end{array}
\]

Find all saddle points.

**Problem 7**
Show that, if a 2×3 matrix has a saddle point, then either one row dominates another, or one column dominates another (or possibly both). Show by a counterexample that this is not true for 3×3 matrices.

**Problem 8** *Shapley’s criterion*
Consider a game \( (S, T, u) \) with finite strategy sets such that for every subsets \( S_0 \subset S, T_0 \subset T \) with 2 elements each, the 2×2 game \( (S_0, T_0, u) \) has a value. Show that the original game has a value.

1.7.2 Mixed strategies

**Problem 9**
Consider the matrix game \( A = \begin{pmatrix} 2 & 4 & 6 & 3 \\ 6 & 2 & 4 & 3 \\ 4 & 6 & 2 & 3 \end{pmatrix} \)

a) What is the minimal payoff player 1 can guarantee himself if he plays the mixed strategy \( s = (\frac{1}{3}, \frac{1}{3}, \frac{1}{3}) \)?
b) Find the value and optimal strategies for both players.

**Problem 10**
Consider the matrix game \( A = \begin{pmatrix} 2 & 0 & 1 & 4 \\ 1 & 2 & 5 & 3 \\ 4 & 1 & 3 & 2 \end{pmatrix} \).

a) Iteratively eliminate dominated strategies.
b) Find the value and optimal strategies for both players.

**Problem 11**
Consider the matrix game \( A = \begin{pmatrix} 2 & 3 & 1 & 5 \\ 4 & 1 & 6 & 0 \end{pmatrix} \).
Find the value of this game and optimal strategies for both players. *Hint: start with player 1.*

**Problem 12**
Find the value and optimal strategies for both players in the matrix games

\[ A = \begin{pmatrix} 1 & 6 & 0 \\ 2 & 0 & 3 \\ 3 & 2 & 4 \end{pmatrix} \]

\[ B = \begin{pmatrix} 0 & 1 & -2 \\ -1 & 0 & 3 \\ 2 & -3 & 0 \end{pmatrix} \]

\[ C = \begin{pmatrix} 12 & 0 \\ 0 & 12 \\ 10 & 6 \\ 8 & 10 \\ 9 & 7 \end{pmatrix} \]

(Hint for c): check for strategies dominated by some of the other player's mixed strategies)

**Problem 13 Hiding a number**
Fix an increasing sequence of positive numbers \( a_1 \leq a_2 \leq a_3 \leq \cdots \leq a_p \leq \cdots \). Each player chooses an integer, the choices being independent. If they both choose the same number \( p \), player 1 receives \( \$p \) from player 2. Otherwise, no money changes hand.

a) Assume first
\[ \sum_{p=1}^{\infty} \frac{1}{a_p} < \infty \]

and show that each player has a unique optimal mixed strategy.

b) In the case where
\[ \sum_{p=1}^{\infty} \frac{1}{a_p} = \infty \]

show that the value is zero, that every strategy of player 1 is optimal, whereas player 2 has only "\( \varepsilon \)-optimal" strategies, i.e., strategies guaranteeing a payoff not larger than \( \varepsilon \), for arbitrarily small \( \varepsilon \).

**Problem 14 Picking an entry**

a) Player 1 chooses either a row or a column of the matrix \( \begin{pmatrix} 2 & 1 \\ 4 & 5 \end{pmatrix} \). Player 2 chooses an entry of this matrix. If the entry chosen by 2 is in the row or column chosen by 1, player 1 receives the amount of this entry from player 2. Otherwise, no money changes hands. Find the value and optimal strategies.

b) Same strategies but this time if player 2 chooses entry \( s \) and this entry is not in the row or column chosen by 1, player 2 gets \( \$s \) from player 1; if it is in the row or column chosen by 1, player 1 gets \( \$s \) from player 2 as before.

**Problem 15 Guessing a number**
Player 2 chooses one of the three numbers 1, 2 or 5. Call \( s_2 \) that choice. One of the two numbers not selected by Player 2 is selected at random (equal probability 1/2 for each) and shown to Player 1. Player 1 now guesses Player 2’s choice: if his guess is correct, he receives \( s_2 \) from Player 2, otherwise no money changes hands.

Solve this game: value and optimal strategies.

*Hint: drawing the full normal form of this game is cumbersome; describe instead the strategy of player 1 by three numbers \( q_1, q_2, q_5 \). The number \( q_1 \) tells what player 1 does if he is shown number 1: he guesses 2 with probability \( q_1 \) and 5 with proba. \( 1 - q_1 \); and so on.*

**Problem 16**

Assume that both players choose optimal (mixed) strategies \( \pi \) and \( \eta \) and thus the resulting payoff in the game is \( v \). We know that player 1 would get \( v \) if against player 2’s choice \( \eta \) he would play any pure strategy with positive probability in \( \pi \) (i.e. any pure strategy \( i \), such that \( \pi_i > 0 \)), and he would get less than \( v \) if he would play any pure strategy \( i \), such that \( \pi_i = 0 \). Explain why a rational player 1, who assumes that his opponent is also rational, should not choose a pure strategy \( i \) such that \( \pi_i > 0 \) instead of \( \pi \).

**Problem 17** *Bluffing game*

At the beginning, players 1 and 2 each put $1 in the pot. Next, player 1 draws a card from a shuffled deck with equal number of black and red cards in it. Player 1 looks at his card (he does not show it to player 2) and decides whether to raise or fold. If he folds, the card is revealed to player 2, and the pot goes to player 1 if it is red, to player 2 if it is black. If player 1 raises, he must add $1 to the pot, then player 2 must meet or pass. If she passes the game ends and player 1 takes the pot. If she meets, she puts $\alpha$ in the pot. Then the card is revealed and, again, the pot goes to player 1 if it is red, to player 2 if it is black.

Draw the matrix form of this game. Find its value and optimal strategies as a function of the parameter \( \alpha \). Is bluffing part of the equilibrium strategy of player 1?

## 2 Nash equilibrium

In a general \( n \)-person game in strategic form, interests of the players are neither identical nor completely opposed. Thus the information each player possesses about other participants in the game may influence her behavior. We discuss in this chapter the two most important scenarios within which the Nash equilibrium concept is often a compelling model of rational behavior:

- the decentralized scenarios where mutual information is minimal, to the extent that a player may not even know how many other players are in the game or what their individual preferences look like;
- the coordinated scenarios where players know a lot about each other’s strategic opportunities (strategy sets) and payoffs (preferences), and use
either deductive reasoning or non binding communication to coordinate their choices of strategies.

Decentralized scenarios are well suited to games involving a large number of players, each one with a relatively small influence on the overall outcome (competitive context). Coordination scenarios are more natural in games with a small number of participants.

This chapter is long on examples and short on abstract proofs (next chapter is just the opposite).

**Definition 18** A game in strategic form is a list $G = (N, S_i, u_i, i \in N)$, where $N$ is the set of players, $S_i$ is player $i$’s strategy set and $u_i$ is his payoff, a mapping from $S_N = \prod_{i \in N} S_i$ into $\mathbb{R}$, which player $i$ seeks to maximize.

**Definition 19** A Nash equilibrium of the game $G = (N, S_i, u_i, i \in N)$ is a profile of strategies $s^* \in S_N$ such that

$$u_i(s^*) \geq u_i(s_i, s_{-i})$$ for all $i$ and all $s_i \in S_i$

Note that the above definition uses only the ordinal preferences represented by the utility functions $u_i$. We use the cardinal representation as payoff (utility) simply for convenience.

### 2.1 Decentralized behavior and dynamic stability

Here the players behave in a simple myopic fashion, and learn about the game by exploring their strategic options over time. Their behavior is compatible with total ignorance about the existence and characteristics of other players, and what their behavior could be.

Think of Adam Smith’s *invisible hand* paradigm: the price signal I receive from the market looks to me as an exogenous parameter on which my own behavior has no effect. I do not know how many other participants are involved in the market, and what they could be doing. I simply react to the price by maximizing my utility, without making assumptions about its origin.

The analog of the competitive behavior in the context of strategic games is the best reply behavior. Take the profile of strategies $s_{-i}$, chosen by other players as an exogeneous parameter, then pick a strategy $s_i$ maximizing your own utility $u_i$, under the assumption that this choice will not affect the parameter $s_{-i}$.

The deep insight of the invisible hand paradigm is that decentralized price taking behavior will result in an efficient allocation of resources (a Pareto efficient outcome of the economy). This holds true under some specific microeconomic assumptions in the Arrow-Debreu model, and consists of two statements. First the invisible hand behavior will converge to a competitive equilibrium; second, this equilibrium is efficient. (The second statement is much more robust than the first).
In the much more general strategic game model, the limit points of the best reply behavior are the Nash equilibrium outcomes. Both statements, the best reply behavior converges, the limit point is an efficient outcome, are problematic. The examples below show that not only the best reply behavior may not converge at all, or if it converges, the limit equilibrium outcome may well be inefficient (Pareto inferior). Decentralized behavior may diverge, or it may converge toward a socially suboptimal outcome.

**Definition 20** Given the game in strategic form \( G = (N, S_i, u_i, i \in N) \), the best-reply correspondence of player \( i \) is the (possibly multivalued) mapping \( br_i \) from \( S_{-i} = \prod_{j \in N \setminus \{i\}} S_j \) into \( S_i \) defined as follows

\[
s_i \in br_i(s_{-i}) \iff u_i(s_i, s_{-i}) \geq u_i(s'_i, s_{-i}) \text{ for all } s_i' \in S_i
\]

**Definition 21** We say that the sequence \( s_t^i \in S_N, t = 0, 1, 2, \ldots \), is a best reply dynamics if for all \( t \geq 1 \) and all \( i \), we have

\[
s_t^i \in \{s_t^{i-1}\} \cup br_i(s_{t-1}^{i-1}) \text{ for all } t \geq 1
\]

and \( s_t^i \in br_i(s_{t-1}^{i-1}) \) for infinitely many values of \( t \)

We say that \( s_t^i \) is a sequential best reply dynamics, also called an improvement path, if in addition at each step at most one player is changing her strategy.

The best reply dynamics is very general, in that it does not require the successive adjustments of the players to be synchronized. If all players use a best reply at all times, we speak of myopic adjustment; if our players take turn to adjust, we speak of sequential adjustment. For instance with two players the latter dynamics is:

If \( t \) is even: \( s_t^1 \in br_1(s_{t-1}^2), s_t^2 = s_{t-1}^2 \)

If \( t \) is odd: \( s_t^2 \in br_1(s_{t-1}^1), s_t^1 = s_{t-1}^1 \)

But the definition allows much more complicated dynamics, where the timing of best reply adjustments varies accross players. An important requirement is that at any date \( t \), every player will be using his best reply adjustment some time in the future. The first observation is an elementary result.

**Proposition 22** Assume the strategy sets \( S_i \) of each player are compact and the payoff functions \( u_i \) are continuous. If the best reply dynamics \( (s_t^i)_{i \in \mathbb{N}} \) converges to \( s^* \in S_N \), then \( s^* \) is a Nash equilibrium.

**Proof.** Pick any \( \varepsilon > 0 \). As \( u_i \) is uniformly continuous on \( S_N \), there exists \( T \) such that

\[|u_i(s_t^i, s_{-j}) - u_i(s_t^*, s_{-j})| \leq \frac{\varepsilon}{n} \text{ for all } s_{-j} \in S_{-j}\]
Fix an agent $i$. By definition of the b.r. dynamics, there is a date $t \geq T$ such that $s_i^{t+1} \in \text{br}_i(s_i^t)$. This implies for any $s_i \in S_i$

$$u_i(s^*) + \varepsilon \geq u_i(s_i^{t+1}, s_{-i}^t) \geq u_i(s_i, s_{-i}^t) \geq u_i(s_i, s_i^*) - \frac{n - 1}{n} \varepsilon$$

where the left and right inequality follow by repeated application of uniform continuity. Letting $\varepsilon$ go to zero ends the proof.

Note that the topological assumptions in the Proposition hold true if the strategy sets are finite.

**Definition 23** We call a Nash equilibrium $s$ strongly globally stable if any best reply dynamics (starting from any initial profile of strategies in $S_N$) converges to $s$. Such an equilibrium must be the unique equilibrium.

We call a Nash equilibrium strongly locally stable if for any neighborhood $N$ of $s$ in $S_N$ there is a sub-neighborhood $M$ of $s$ such that any best reply dynamics starting in $M$ stays in $N$.

We call a Nash equilibrium weakly globally stable if any sequential best reply dynamics (starting from any initial profile of strategies in $S_N$) converges to it. Such an equilibrium must be the unique equilibrium.

We call a Nash equilibrium weakly locally stable if for any neighborhood $N$ of $s$ in $S_N$ there is a sub-neighborhood $M$ of $s$ such that any sequential best reply dynamics starting in $M$ stays in $N$.

Note that if strategy sets are finite, the concept of local stability (in both versions) has no bite (every equilibrium is strongly locally stable). However when the number of agents is large we can measure the deviation from an equilibrium by the number of agents who are not playing the equilibrium strategy. This leads to the simple concept of $\lambda$-stability, where $\lambda$ is a parameter s.t. $0 < \lambda < 1$: If the fraction of deviating agents is not more than $\lambda$, any sequential b.r. dynamics converges back to the equilibrium. The interpretation of $\lambda$-stability is similar to that of weak local stability. See example 2 below.

### 2.1.1 stable and unstable equilibria

We give a series of examples illustrating these definitions. The actual analysis of each game is done in class.

**Example 1:** two-person zero sum games

Here a Nash equilibrium is precisely a saddle point. In the following game, a saddle point exists and is globally stable

$$\begin{bmatrix}
4 & 3 & 5 \\
5 & 2 & 0 \\
2 & 1 & 6
\end{bmatrix}$$

In the next game, a saddle point exists but is not even weakly stable:

$$\begin{bmatrix}
4 & 1 & 0 \\
3 & 2 & 3 \\
0 & 1 & 4
\end{bmatrix}$$
Example 2: Schelling’s model of binary choices
Each player has a binary choice, $S_i = \{0, 1\}$, and the game is symmetrical, therefore it is represented by two functions $a(\cdot), b(\cdot)$ as follows

$$u_i(s) = a(\sum_N s_i) \text{ if } s_i = 1$$
$$= b(\sum_N s_i) \text{ if } s_i = 0$$

Interpretation: vaccination, choice of network, of language, etc. Assuming a large number of agents, we can draw $a, b$ as continuous functions and check that the Nash equilibrium outcomes are at the intersections of the 2 graphs, at $s = (0, \cdots, 0)$ if $a(0) \leq b(0)$, and at $s = (1, \cdots, 1)$ if $a(1) \geq b(1)$. They are unstable if $a$ cuts $b$ from below, and λ-sable if $a$ cuts $b$ from above. If the equilibrium is unique it is weakly globally stable but not strongly stable, even weakly.

Example 3: price cycles in the Cournot oligopoly
The demand function and its inverse are

$$D(p) = (a - bp)_+ \iff D^{-1}(q) = (a - q)_+ b$$

Firm $i$ incurs the cost $C_i(q_i) = \frac{q_i^2}{c_i}$, therefore its competitive supply given the price $p$ is $O_i(p) = c_i p$, and total supply is $O(p) = (\sum_N c_j)p$. Assume there are many agents, each one small w.r.t. the total market size (i.e., each $c_i$ is small w.r.t. $\sum_N c_j$), so that the competitive price-taking behavior is a good approximation of the best reply behavior. Strategies here are the quantities $q_i$ produced by the firms, and utilities are

$$u_i(q) = D^{-1}(\sum_N q_j)q_i - C_i(q_i)$$

The equilibrium is unique, at the intersection of the $O$ and $D$ curves. If $\frac{b}{c} > 1$ it is strongly globally stable; if $\frac{b}{c} < 1$ it is not strongly stable yet weakly globally stable.

In our last example, the game has no Nash equilibrium, therefore the best reply dynamics cycles for ever. To check that no equilibrium exists, we use an important inequality always satisfied in equilibrium.

Lemma 24 If $s^*$ is a Nash equilibrium of the game $G = (N, S_i, u_i, i \in N)$, we have for all $i$

$$u_i(s^*) \geq \min_{s_{-i} \in S_{-i}} \max_{s_i \in S_i} u_i(s_i, s_{-i})$$

Example 4 duopoly a la Hoteling
The two competitors sell identical goods at fixed prices $p_1, p_2$ such that $p_1 < p_2$. The consumers are uniformly spread on $[0, 1]$, each with a unit demand. Firms
incur no costs. Firms choose independently where to locate a store on the
interval \([0,1]\), then consumers buy from the cheapest store, taking into account
a transportation cost of \(s\) if \(s\) is the distance to the store. Assume \(p_2 - p_1 = \frac{1}{4}\).
Check that
\[
\min_{S_2} \max_{S_1} u_1 = p_1; \quad \min_{S_1} \max_{S_2} u_2 = \frac{p_2}{s}
\]
and that the payoff profile \((1, \frac{1}{8})\) is not feasible. Therefore the game has no Nash equilibrium.

2.1.2 potential games

We introduce three classes of games where some form of stability is guaranteed.

**Definition 25** A game in strategic form \(G = (N, S_i, u_i, i \in N)\) is a potential
game if there exists a real valued function \(P\) defined on \(S_N\) such that for all \(i\) and \(s_{-i} \in S_{-i}\) we have
\[
u_i(s_i, s_{-i}) - u_i(s'_i, s_{-i}) = P(s_i, s_{-i}) - P(s'_i, s_{-i}) \text{ for all } s_i, s'_i \in S_i.
\]
Thus the original game \(G = (N, S_i, u_i, i \in N)\), and the game \(P = (N, S_i, P, i \in N)\) with the same strategy sets as \(G\) and identical payoffs \(P\) for all players, have
the same best reply correspondences therefore the same Nash equilibria. Call \(s^*\) a coordinate-wise maximum of \(P\) if for all \(i, s_i \rightarrow P(s_i, s^*_{-i})\) reaches its maximum at \(s^*_i\). Clearly \(s\) is a Nash equilibrium (of \(G\) and \(P\)) if and only if it is a coordinate-wise maximum of \(P\).

If \(P\) reaches its global maximum on \(S_N\) at \(s\), this outcome is a Nash equilibrium of \(P\) and therefore of \(G\). Thus potential games with continuous payoff functions and compact strategy sets always have at least a Nash equilibrium.

Moreover, the best reply dynamics has very appealing stability properties.

**Proposition 26** Let \(G = (N, S_i, u_i, i \in N)\) be a potential game where the sets \(S_i\) are compact and the payoff functions \(u_i\) are continuous,

i) Any sequential best reply dynamics converges to a Nash equilibrium.

ii) If there is a unique Nash equilibrium, it is weakly globally stable.

iii) If a Nash equilibrium of \(G\) is a local maximum, locally unique, of the potential \(P\), this equilibrium is weakly locally stable.

Note that a general statement about strong stability is out of reach, even in games with identical payoffs! Think of the 2 player game with \(u_i(s) = P(s) = f(s_1 + s_2)\).

**Example 5:** the Braess paradox

There are two roads to go from \(A\) to \(B\), and 6 commuters want to do just that. The upper road goes through \(C\), the lower road goes through \(D\). The 2 roads only meet at \(A\) and \(B\). On each of the four legs, \(AC, CB, AD, DB\), the travel time depends upon the number of users \(m\) in the following way:

on \(AC\) and \(DB\) : \(50 + m\), on \(CB\) and \(AD\) : \(10m\)
Every player must choose a road to travel, and seeks to minimize his travel time. The Nash equilibria of the game are all outcomes with 3 users on each road, and they all give the same disutility 83 to each player. We now add one more link on the road network, directly between C and D, with travel time $10 + m$. In the new Nash equilibrium outcomes, we have two commuters on each of the paths $ACB, ADB, ADCB$, and their disutility is 92. Thus the new road results in a net increase of the congestion!

We explain in example 7 below why the two versions of the game above are potential games.

**Example 6** public good provision by voluntary contributions

Each player $i$ contributes an amount of input $s_i$ toward the production of a public good, at a cost $C_i(s_i)$. The resulting level of public good is $B(\sum_i s_i) = B(s_N)$. Hence the payoff functions

$$u_i = B(s_N) - C_i(s_i) \text{ for } i = 1, \cdots, n$$

The potential function is

$$P(s) = b(s_N) - \sum_i c_i(s_i)$$

therefore existence of a Nash equilibrium is guaranteed if $B, C_i$ are continuous and the potential is bounded over $\mathbb{R}^N$.

The public good provision model is a simple and compelling argument in favor of centralized control of the production of pure public goods. To see that in equilibrium the level of production is grossly inefficient, compare $P$ with total utility

$$\sum_i u_i(s) = nB(s_N) - \sum_i C_i(s_i)$$

Assume $C_i$ is increasing and strictly convex while $B$ is increasing and strictly concave. Then the Nash equilibrium outcome $s^*$ is unique, hence globally stable. It is computed by solving

$$z = \sum_i \gamma_i(B'(z)) \text{ where } \gamma_i \text{ is the inverse of } C'_i$$

and setting

$$s^*_i = \gamma_i(B'(z^*))$$

Clearly the equilibrium level of public good $z^*$ is much lower than the efficient level maximizing $\sum_i u_i$.

The much more general version of the game where the common benefit is an arbitrary function $B(s) = B(s_1, \cdots, s_n)$, remains a potential game for $P = B - \sum_i C_i$, therefore existence of a Nash equilibrium is still guaranteed. See example 15 and problem 7 for two alternative choices of $B$.

**Example 7** congestion games

These games generalize both examples 2 and 5. Each player $i$ chooses from the same strategy set and her payoff only depends upon the number of other
players making the same choice. Examples include choosing a travel path between a source and a sink when delay is the only consideration, choosing a club for the evening if crowding is the only criteria and so on.

\[ S_i = S \text{ for all } i; \quad u_i(s) = f_x(n_{s_i}(s)) \text{ where } n_x(s) = |\{ j \in N | s_j = x \}| \text{ and } f_x \text{ is arbitrary. Here the potential function is} \]

\[ P(s) = \sum_{x \in S} \sum_{m=1}^{n_x(s)} f_x(m) \]

In a congestion game any sequential best reply dynamics converges to a Nash equilibrium, therefore the decentralized behavior of our commuters is convincingly captured by these outcomes.

2.1.3 dominance-solvable games

**Definition 27** In the game in strategic form \( G = (N, S_i, u_i, i \in N) \), we say that player \( i \)'s strategy \( s_i \) is strictly dominated by his strategy \( s'_i \) if

\[ u_i(s_i, s_{-i}) < u_i(s'_i, s_{-i}) \text{ for all } s_{-i} \in S_{-i} \]

Given a subset of strategies \( T_i \subset S_i \) we write \( U_i(T_N) \) for the set of player \( i \)'s strategies in the restricted game \( G(T_N) = (N, T_i, u_i, i \in N) \) that are not strictly dominated.

**Definition 28** We say that the game \( G \) is strictly dominance-solvable if the sequence defined inductively by

\[ S_0^t = S_i; \quad S_i^{t+1} = U_i(S_N^t) \text{ for all } i \text{ and } t = 1, 2, \ldots \]

and called the successive elimination of strictly dominated strategies, converges to a single outcome \( s^* \):

\[ \cap_{t=1}^{\infty} S_N^t = \{ s^* \} \]

**Proposition 29** Under this assumption, \( s^* \) is the single Nash equilibrium outcome of the game, and it is strongly globally stable.

**Example 8** Guessing game

Each one of the \( n \) players chooses an integer \( s_i \) between 1 and 1000. Compute the average response

\[ \bar{s} = \frac{1}{n} \sum_i s_i \]

The winner (or winners) is the player whose bid is closest to \( \frac{2}{3} \bar{s} \). Here the successive elimination process leads rapidly to \( \cap_{t=1}^{\infty} S_N^t = \{(1, \ldots, 1)\} \). Yet in experimental testing the first time a given group of subjects play the game the average response \( \bar{s} \) is typically between 200 and 300.

**Example 9** Cournot duopoly
This game is dominance-solvable if costs and demand are linear:

\[ u_i = (A - s_{\{1,2\}}) + s_i - c_is_i \text{ for } i = 1, 2 \]

A class of games closely related to dominance-solvable games consist of those where the best reply functions (or correspondences) are non decreasing.

**Proposition 30** Assume the sets \( S_i \) are real intervals \([a_i, b_i]\) and the best reply functions in the game \( G = (N, S_i, u_i, i \in N) \) are single valued and non decreasing

\[ s_{-i} \leq s'_{-i} \Rightarrow \text{br}_i(s_{-i}) \leq \text{br}_i(s'_{-i}) \text{ for all } i \text{ and } s_{-i} \in S_{-i} \]

Then the successive elimination of strictly dominated strategies converges to \([s_-, s_+], \) where \( s_- \) is the smallest Nash equilibrium outcome and \( s_+ \) is the largest:

\[ \cap_{i=1}^{\infty} S_N^i = [s_-, s_+] \]

Any best reply dynamics starting from \( a \) converges to \( s_- ; \) any best reply dynamics starting form \( b \) converges to \( s_+ . \)

In particular if the game has a unique equilibrium outcome, it is strictly dominance-solvable.

**Example 10** A search game
Each player exerts effort searching for new partners. The probability that player \( i \) finds any other player is \( s_i, 0 \leq s_i \leq 1, \) and when \( i \) and \( j \) meet, they derive the benefits \( \alpha_i \) and \( \alpha_j \) respectively. The cost of the effort is \( C_i(s_i) . \) Hence the payoff functions

\[ u_i(s) = \alpha_is_is_N\setminus\{i\} - C_i(s_i) \text{ for all } i \]

To ensure a single valued best reply function, we may assume that \( C_i \) is increasing and convex. However this assumption is not necessary, as explained in Problem 17. Assuming only that \( C_i \) is increasing, we find that \( s = 0 \) is always an equilibrium, but the largest equilibrium is Pareto superior. Examples computed in class with \( C_i \) linear or quadratic.

**Example 11** price competition
Each firm has a linear cost production (set to zero without loss of generality) and chooses a non negative price \( p_i \). The resulting demand and net payoff for firm \( i \) are

\[ D_i(p) = (A_i - \frac{\alpha_i}{3}p_i^2 + \sum_{j \neq i} \beta_jp_j)_+ \text{ and } u_i(p) = p_iD_i(p) \]

The game has increasing best reply functions. In the symmetric case its equilibrium is unique hence the game is dominance-solvable.
2.2 coordination and Nash equilibrium

We now consider games in strategic form involving only a few players who use their knowledge about other players strategic options to form expectations about the choices of these players, which in turn influence their own choices. In the simplest version of this analysis, each player knows the entire strategic form of the game, including strategy sets and individual preferences (payoffs). Yet at the time they make their strategic decision, they act independently of one another, and cannot observe the choice of any other player.

The two main interpretations of the Nash equilibrium are then the self fulfilling prophecy and the self enforcing agreement. The former is the meta-argument that if a "Book of Rational Conduct" can be written that gives me a strategic advice for every conceivable game in strategic form, this advice must be to play a Nash equilibrium. The latter assumes the players engage in "pre-play" communication, and reach a non committal agreement on what to play, followed by a complete break up of communication (Schelling’s story of the parachutists).

In this context, the Nash equilibrium concept runs into the selection problem: if a game has multiple equilibria it is often unclear how the players will be able to coordinate on one of them (section 2.2.1). Then even if a Nash equilibrium is unique, it may be challenged by other strategic choices that are safer or appear so.

On the other hand in dominance-solvable games, selecting the Nash outcome by deduction (covert communication) is quite convincing, and our confidence in the predictive power of the concept remains intact.

2.2.1 the selection problem

When several (perhaps an infinity of) Nash outcomes coexist, and the players’ preferences about them do not agree, they will try to force their preferred outcome by means of tactical commitment. This fundamental difficulty is illustrated by the two following celebrated games.

Example 12 crossing game (a.k.a. the Battle of the Sexes)
Each player must stop or go. The payoffs are as follows

<table>
<thead>
<tr>
<th></th>
<th>stop</th>
<th>go</th>
</tr>
</thead>
<tbody>
<tr>
<td>stop</td>
<td>1, 1</td>
<td>1 - ε, 2</td>
</tr>
<tr>
<td>go</td>
<td>2, 1 - ε</td>
<td>0, 0</td>
</tr>
</tbody>
</table>

Each player would like to commit to go, so as to force the other to stop. There is a mixed strategy equilibrium as well, but it has its own problems. See Section 3.3.

Example 13 Nash demand game
The two players share a dollar by the following procedure: each write the amounts she demands in a sealed envelope. If the two demands sum to no more than $1, they are honored. Otherwise nobody gets any money. In this game the equal split outcome stands out because it is fair, and this will suffice
in many cases to achieve coordination. However, a player will take advantage of an opportunity to commit to a high demand.

Our next example is a versatile model capturing the same intuition as examples 12, 13, namely that "burning your bridges" can be the winning move provided one does it first and other players are sure to notice.

A game of timing takes the following form. Each one of the two players must choose a time to stop the clock between $t = 0$ and $t = 1$. If player $i$ stops the clock first at time $t$, his payoff is $u_i = a(t)$, that of player $j$ is $u_j = b(t)$. In case of ties, each gets the payoff $\frac{1}{2}(a(t) + b(t))$. An example is the noisy duel of chapter 1, where $a$ increases, $b$ increases, and they intersect at the optimal stopping/shooting time.

Example 14 war of attrition
This is a game of timing where both $a$ and $b$ are continuous and decreasing, $a(t) < b(t)$ for all $t$, and $b(1) < a(0)$. There are two Nash equilibrium outcomes. Setting $t^*$ as the time at which $a(0) = b(t^*)$, one player commits to $t^*$ or more, and the other concedes by stopping the clock immediately (at $t = 0$).

Sometimes the selection problem is facilitated because the players agree on the most favorable equilibrium: the Pareto dominance argument. A simple example is any coordination game where all players have the same payoffs: $u_i(s) = u_j(s)$ for all $s$ and all $i, j$. If there is a single outcome maximizing the common payoff, it will be selected without explicit communication. When several outcomes are optimal, we may hope that one of them is more salient, as in Schelling’s rendez-vous game.

Finally prudence may point to some particular equilibrium outcome. But this criterion may conflict with Pareto dominance as in the hat story, and in the following important game.

Example 15 coordination failure
This is an example of a public good provision game by voluntary contributions (example 6), where individual contributions enter the common benefit function as perfect complements:

$$u_i(s) = \min_j s_j - C_i(s_i)$$

Examples include the building of dykes or a vaccination program: the safety provided by the dyke is only as good as that of its weakest link. Assume $C_i$ is convex and increasing, with $C_i(0) = 0$ and $C_i'(0) < 1$, so that each player has a stand alone optimal provision level $s_i^*$ maximizing $z - C_i(z)$. Then the Nash equilibria are the outcomes where $s_i = \lambda$ for all $i$, and $0 \leq \lambda \leq \min_i s_i^*$. They are Pareto ranked: the higher $\lambda$, the better for everyone. However the higher $\lambda$, the more risky the equilibrium: if other players may make an error and fail to send their contribution, it is prudent not to send anything ($\max s_i \min s_{-i} u_i(s) = 0$ is achieved with $s_i = 0$). Even if the probability of an error is very small, a reinforcement effect will amplify the risk till the point where only the null (prudent) equilibrium is sustainable.
2.2.2 dominance solvable games

Eliminating dominated strategies is the central coordination device performed by independent deductions of completely informed agents.

**Definition 31** In the game $G = (N, S, u, i \in N)$, we say that player $i$’s strategy $s_i$ is weakly dominated by his strategy $s'_i$ (or simply dominated) if

$$u_i(s_i, s_{-i}) \leq u_i(s'_i, s_{-i}) \text{ for all } s_{-i} \in S_{-i}$$

Given a subset of strategies $T_i \subset S_i$ we write $WU_i(T_N)$ for the set of player $i$’s strategies in the restricted game $(N, T_i, u, i \in N)$ that are not dominated.

**Definition 32** We say that the game $G$ is dominance-solvable if the sequence defined inductively by

$$w_{S_i}^0 = S_i; w_{S_i}^{t+1} = WU_i(w_{S_i}^t) \text{ for all } i \text{ and } t = 1, 2, \ldots$$

and called the successive elimination of dominated strategies, converges to a single outcome $s^*$:

$$\cap_{t=1}^{\infty} w_{S_i}^t = \{ s^* \}$$

Notice an important difference between the elimination of strictly versus weakly dominated strategies. The former never loses a Nash equilibrium in the following sense (with the notations of Definition 28):

$$\{ s \text{ is a Nash equilibrium of } G \} \Rightarrow s \in \cap_{t=1}^{\infty} S_i^t$$

By contrast the elimination of weakly dominated strategies may lose some, or even all, Nash equilibria along the way. Here is a two person example

$$\begin{bmatrix}
1 & 3 & 2,0 & 3,1 \\
0,2 & 2,2 & 0,2 \\
3,1 & 2,0 & 1,3
\end{bmatrix}$$

Thus the algorithm may throw out the baby with the water!

Another difference between the two successive elimination algorithms is their robustness with respect to partial elimination. Suppose, in the case where we only drop strictly dominated strategies, that at each stage we choose $S_i^{t+1}$ as a subset of $U_i(S_N^t)$: then it is easy to check that the limit set $\cap_{t=1}^{\infty} S_N^t$ is unaffected (provided we eventually take all elimination opportunities)(exercise: prove this claim). On the other hand when we only drop some weakly dominated strategies at each stage, the result of the algorithm may well depend on the choice of subsets $w_{S_i}^{t+1}$ in $WU_i(w_{S_i}^t)$. Here is an example:

$$\begin{bmatrix}
2,3 & 2,3 \\
3,2 & 1,2 \\
1,1 & 0,0 \\
0,0 & 1,1
\end{bmatrix}$$

28
Despite the difficulty above, in many instances the elimination algorithm in Definition 33 leads to a convincing equilibrium selection.

**Example 16 the chair’s paradox**

Three voters choose one of three candidates \(a, b, c\). The rule is plurality with the Chair, player 1, breaking ties. Hence each player \(i\) chooses from the set \(S_i = \{a, b, c\}\), and the elected candidate for the profile of votes \(s\) is

\[
s_2 \text{ if } s_2 = s_3; \text{ or } s_1 \text{ if } s_2 \neq s_3
\]

Assume that the preferences of the voters exhibit the cyclical pattern known as the Condorcet paradox, namely

\[
\begin{align*}
&u_1(c) < u_1(b) < u_1(a) \\
&u_2(b) < u_2(a) < u_2(c) \\
&u_3(a) < u_3(c) < u_3(b)
\end{align*}
\]

Writing this game in strategic form reveals that after the successive elimination of dominated strategies, the single outcome \(s = (a, c, c)\) remains. This is a Nash equilibrium outcome. The paradox is that the chair’s tie-breaking privilege result in the election of her worst outcome!

**Example 17 first price auction**

An object is auctioned between \(n\) bidders who each submit a sealed bid \(s_i\). Bids are in round dollars (so \(S_i = \mathbb{N}\)). The highest bidder gets the object and pays his bid. In case of a tie, a winner is selected at random with uniform probability among the highest bidders.

Assume that the valuations of (willingness to pay for) the object are also integers \(u_i\) and that

\[u_1 > u_i \text{ for all } i \geq 2\]

At a Nash equilibrium of this game, the object is awarded to player 1 at a price anywhere between \(u_1 - 1\) and \(u_2\). However after two rounds of elimination we find that player 1 bids \(u_2\) while player \(i, i \geq 2\), bids \(u_i - 1\): player 1 exploits his informational advantage to the full.

**Example 18 Steinhaus cake division method**

The referee runs a knife from the left end of the cake to its right end. Each one of the two players can stop the knife at any moment. Whoever stops the knife first gets the left piece, the other player gets the right piece. If both players have identical preferences over the various pieces of the cake, this is a game of timing structurally equivalent to the noisy duel, and its unique Nash equilibrium is that they both stop the knife at the time \(t^*\) when they are indifferent between the two pieces. When preferences differ, call \(t_i^*\) the time when player \(i\) is indifferent between the two pieces, and assume \(t_1^* < t_2^*\). The Nash equilibrium outcomes are those where player 1 stops the knife between \(t_1^*\) and \(t_2^*\) while player 2 is just about to stop it herself: player 1 gets the left piece (worth more than the right piece to him) and player 2 gets the right piece (worth more to her than the left
piece). However after two rounds of elimination of dominated strategies, we are left with $S^1_2 = [t^*_2 - \varepsilon, 1], S^2_2 = [t^*_2, 1]$. Although the elimination process stops there, the outcome of the remaining game\(^1\) is not in doubt: $s^*_1 = t^*_2 - \varepsilon, s^*_2 = t^*_2$.

### 2.2.3 Dominant Strategy Equilibrium

One case where the successive elimination of even weakly dominated strategies is convincing is when each player has a dominant strategy. Put differently the following is a compelling equilibrium selection.

**Definition 33** In the game $G = (N, S_i, u_i, i \in N)$, we say that player $i$’s strategy $s^*_i$ is dominant if

$$u_i(s^*_i, s_{-i}) \geq u_i(s, s_{-i}) \text{ for all } s_{-i} \in S_{-i}, \text{ all } s_i \in S_i$$

We say that $s^*$ is a dominant strategy equilibrium if for each player $i$, $s^*_i$ is a dominant strategy.

There is a huge difference in the interpretation of a game where dominance solvability (whether in the strict or weak form) identifies a Nash equilibrium, versus one where a dominant strategy equilibrium exists. In the latter all a player has to know are the strategy sets of other players; their preferences or their actual strategic choices do not matter at all to pick his dominant strategy. Information about other players’ payoffs or moves is worthless, as long as our player is unable to influence their choices (for instance a threat of the kind "if you do this I will do that" is not enforceable).

A game with an equilibrium in dominant strategies is weakly, but not necessarily strictly, dominance-solvable.

The most famous example of such an equilibrium is the Prisoners Dilemma.

**Example 19** Prisoners Dilemma

Each player chooses a *selfish* strategy $C$ or a *selfish* strategy $D$. Choosing $C$ brings a benefit $a$ to every other player and a cost of $b$ to me. Playing $D$ brings neither benefit nor cost to anyone. It is a dominant strategy to play $D$ if $b > 0$. If furthermore $b < (n-1)a$, the dominant strategy equilibrium is Pareto inferior to the unanimously selfish outcome.

Dominant strategy equilibria do not happen in very many games because the strategic interaction is often more complex. However they are so appealingly simple that when we design a procedure to allocate resources, elect one of the candidates to a job, or divide costs, we would like the corresponding strategic game to have a dominant strategy equilibrium as often as possible. In this way we are better able to predict the behavior of our participants. The two most celebrated examples of such strategy-proof allocation mechanisms follow. In both cases the game has a dominant strategy equilibrium in all cases, and the corresponding outcome is efficient (Pareto optimal).

**Example 20** Vickrey’s second price auction

\[^{1}\]This game is an inessential game, as discussed in question a) of problem 18.
An object is auctioned between $n$ bidders who each submit a sealed bid $s_i$. Bids are in round dollars (so $S_i = \mathbb{N}$). The highest bidder gets the object and pays the second highest bid. In case of a tie, a winner is selected at random with uniform probability among the highest bidders (and pays the highest bid). If player $i$'s valuation of the object is $u_i$, it is a dominant strategy to bid "sincerely", i.e., $s^*_i = u_i$. The corresponding outcome is the same as in the Nash equilibrium that we selected by dominance-solvability in the first price auction (example 17). But to justify that outcome we needed to assume complete information, in particular the highest valuation player must know precisely the second highest valuation. By contrast in the Vickrey auction, each player knows what bid to slip in the envelope, whether or not she has any information about other players' valuations, or even their number.

It is interesting to note that in the second price auction game, there is a distressing variety of Nash equilibrium outcomes and in particular any player, even the one with the lowest valuation of all, receives the object in some equilibrium.

**Example 21** voting under single-peaked preferences
The $n$ players vote to choose an outcome $x$ in $[0, 1]$. Assume for simplicity $n$ is odd. Each player submits a ballot $s_i \in [0, 1]$, and the median outcome among $s_1, \cdots, s_n$ is elected: this is the number $x = s_i^*$ such that more than half of the ballots are no less than $x$, and more than half of the ballots are no more than $x$. Preferences of player $i$ over the outcomes are single-peaked with the peak at $v_i$: they are strictly increasing on $[0, v_i]$ and strictly decreasing on $[v_i, 1]$.

Here again, it is a dominant strategy to bid "sincerely", i.e., $s^*_i = v_i$. Again, any outcome $x$ in $[0, 1]$ results from a Nash equilibrium, so the latter concept has no predictive power at all in this game.

### 2.3 problems on chapter 2

**Problem 1**
In Schelling’s model (example 2) find examples of the functions $a$ and $b$ such that the equilibrium is unique and strongly globally stable; such that it is unique and weakly but not strongly globally stable.

**Problem 2** games of timing
a) We have two players, $a$ and $b$ both increase, and $a$ intersects $b$ from below. Perform the successive elimination of dominated strategies, and find all Nash equilibria. Can they be Pareto improved?

b) We extend the war of attrition (example 14) to $n$ players. If player $i$ stops the clock first at time $t$, his payoff is $u_i = a(t)$, that of all other players is $u_j = b(t)$. Both $a$ and $b$ are continuous and decreasing, $a(t) < b(t)$ for all $t$, and $b(1) < a(0)$. Answer the same questions as in a).

c) We have $n$ players as in question b), but this time $a$ increases, $b$ decreases, and they intersect.

**Problem 3** examples of best reply dynamics
a) We have a symmetric two player game with $S_i = [0, 1]$ and the common best
reply function

\[ br(s) = \min\{s + \frac{1}{2}, 2 - 2s\} \]

Show that we have three Nash equilibria, all of them locally unstable, even for the sequential dynamics.
b) We have three players, \( S_i = \mathbb{R} \) for all \( i \), and the payoffs

\[
\begin{align*}
    u_1(s) &= -s_1^2 + 2s_1s_2 - s_2^2 + s_1 \\
    u_2(s) &= -9s_2^2 + 6s_2s_3 - s_3^2 + s_2 \\
    u_3(s) &= -16s_1^2 - 9s_2^2 - s_3^2 + 24s_1s_2 - 6s_2s_3 + 8s_1s_3 + s_3
\end{align*}
\]

Show there is a unique Nash equilibrium and compute it. Show the sequential best reply dynamics where players repeatedly take turns in the order 1, 2, 3 does not converge to the equilibrium, whereas the dynamics where they repeatedly take turns in the order 2, 1, 3 does converge from any initial point. What about the myopic adjustment where each player uses his best reply at each turn?

**Problem 4 ordinal potential games**

Let \( \sigma \) be the sign function \( \sigma(0) = 0, \sigma(z) = 1 \) if \( z > 0, = -1 \) if \( z < 0 \). Call a game \( G = (N, S_i, u_i, i \in N) \) an ordinal potential game if there exists a real valued function \( P \) defined on \( S_N \) such that for all \( i \) and \( s_{-i} \in S_{-i} \) we have

\[
\sigma\{u_i(s_i, s_{-i}) - u_i(s'_i, s_{-i})\} = \sigma\{P(s_i, s_{-i}) - P(s'_i, s_{-i})\} \text{ for all } s_i, s'_i \in S_i
\]

a) Show that the search game (example 10) and the price competition (example 11) are ordinal potential games.
b) Show that the following Cournot oligopoly game is an ordinal potential game. Firm \( i \) chooses a quantity \( s_i \), and \( D^{-1} \) is the inverse demand function. Costs are linear and identical:

\[
u_i(s) = s_iD^{-1}(s_N) - cs_i \text{ for all } i \text{ and all } s
\]

c) Show that Proposition 26 still holds for ordinal potential games.

**Problem 5 third price auction**

We have \( n \) bidders, \( n \geq 3 \), and bidder \( i \)'s valuation of the object is \( u_i \). Bids are independent and simultaneous. The object is awarded to the highest bidder at the third highest price. Ties are resolved just like in the Vickrey auction, with the winner still paying the third highest price. We assume for simplicity that the profile of valuations is such that \( u_1 > u_2 > u_3 \geq u_i \) for all \( i \geq 4 \).
a) Find all Nash equilibria.
b) Find all dominated strategies of all players and all Nash equilibria in undominated strategies.
c) Is the game dominance-solvable?

**Problem 6 tragedy of the commons**

A pasture produces 100 units of grass, and a cow transforms \( x \) units of grass into \( x \) units of meat (worth $x$), where \( 0 \leq x \leq 10 \), i.e., a cow eats at most 10
units of grass. It cost $2 to bring a cow to and from the pasture (the profit from a cow that stays at home is $2). Economic efficiency requires to bring exactly 10 cows to the pasture, for a total profit of $80. A single farmer owning many cows would do just that.

Our $n$ farmers, each with a large herd of cows, can send any number of cows to the commons. If farmer $i$ sends $s_i$ cows, $s_N$ cows will share the pasture and each will eat $\min\left\{\frac{100}{n}, 10\right\}$ units of grass.

a) Write the payoff functions and show that in any Nash equilibrium the total number $s_N$ of cows on the commons is bounded as follows

$$50 \frac{n-1}{n} - 1 \leq s_N \leq 50 \frac{n-1}{n} + 1$$

b) Deduce that the commons will be overgrazed by at least 150% and at most 400%, depending on $n$, and that almost the entire surplus will be dissipated in equilibrium. (Hint: start by assuming that each farmer sends at most one cow).

**Problem 7 a public good provision game**

The common benefit function is $b(s) = \max_j s_j$: a single contributor is enough. Examples include R&D, ballroom dancing (who will be the first to dance) and dragon slaying (a lone knight must kill the dragon). Costs are quadratic, so the payoff functions are

$$u_i(s) = \max_j s_j - \frac{1}{2\lambda_i} s_i^2$$

where $\lambda_i$ is a positive parameter differentiating individual costs.

a) Show that in any Nash equilibrium, only one agent contributes.

b) Show that there are $p$ such equilibria, where $p$ is the number of players $i$ such that

$$\lambda_i \geq \frac{1}{2} \max_j \lambda_j$$

Show that each equilibrium is weakly locally stable.

c) Compute strictly dominated strategies for each player. For what profiles $(\lambda_i)$ is our game (strictly) dominance-solvable?

**Problem 8 the lobbyist game**

The two lobbyists choose an ‘effort’ level $s_i$, $i = 1, 2$, measured in money (the amount of bribes distributed) and the indivisible prize worth $\$a$ is awarded randomly to one of them with probabilities proportional to their respective efforts (if the prize is divisible, no lottery is necessary). Hence the payoff functions

$$u_i(s) = a \frac{s_i}{s_1 + s_2} - s_i \text{ if } s_1 + s_2 > 0; u_i(0, 0) = 0$$

a) Compute the best reply functions and show there is a unique Nash equilibrium.

b) Perform the successive elimination of strictly dominated strategies, and check the game is not dominance-solvable. However, if we eliminate an arbitrarily
small interval \([0, \varepsilon]\) from the strategy sets, the reduced game is dominance solvable.

c) Show that the Nash equilibrium (of the full game) is strongly globally stable.

**Problem 9 more congestion games**

We generalize the congestion games of example 7. Now each player chooses among subsets of a fixed finite set \(S\), so that \(s_i \subset 2^S\). The same congestion function \(f_x(m)\) applies to each element \(x\) in \(S\). The payoff to player \(i\) is

\[
u_i(s) = \sum_{x \in s_i} f_x(n_x(s))\]

where \(n_x(s) = |\{j \in N | x \in s_j\}|\)

Interpretation: each commuter chooses a different route (origin and destination) on a common road network represented by a non oriented graph. Her own delay is the sum of the delays on all edges of the network.

Show that this game is still a potential game.

**Problem 10 price competition**

The two firms have constant marginal cost \(c_i, i = 1, 2\) and no fixed cost. They sell two substitutable commodities and compete by choosing a price \(s_i, i = 1, 2\). The resulting demands for the 2 goods are

\[
D_i(s) = \left(\frac{\beta_j}{s_i}\right)^{\alpha_i}
\]

where \(\alpha_i > 0\). Show that there is an equilibrium in dominant strategies and discuss its stability.

**Problem 11 Cournot duopoly with increasing or U-shaped returns**

In all 3 questions the duopolists have identical cost functions \(C\).

a) The inverse demand is \(D^{-1}(q) = (150 - q)_+\) and the cost is

\[
C(q) = 120q - \frac{2}{3}q^2 \text{ for } q \leq 90; = 5400 \text{ for } q \geq 90
\]

Show that we have three equilibria, two of them strongly locally stable.

b) The inverse demand is \(D^{-1}(q) = (130 - q)_+\) and the cost is

\[
C(q) = \min\{50q, 30q + 600\}
\]

Compute the equilibrium outcomes and discuss their (local) stability.

c) The inverse demand is \(D^{-1}(q) = (150 - q)_+\) and the cost is

\[
C(q) = 2025 \text{ for } q > 0; = 0 \text{ for } q = 0
\]

Show that we have three equilibria and discuss their (local) stability.

**Problem 12 Cournot oligopoly with linear demand and costs**

The inverse demand for total quantity \(q\) is

\[
D^{-1}(q) = \mathbf{p}(1 - \frac{q}{\bar{q}})_+
\]
where \( \bar{p} \) is the largest feasible price and \( \bar{q} \) the supply at which the price falls to zero. Each firm has constant marginal cost \( c_i \) and no fixed cost.

a) If all marginal costs \( c_i \) are identical, show there is a unique Nash equilibrium, where all firms are active if \( \bar{p} > c_i \), and all are inactive otherwise.

b) If the marginal costs \( c_i \) are arbitrary and \( c_1 \leq c_2 \leq \cdots \leq c_n \), let \( m \) be zero if \( \bar{p} \leq c_1 \) and otherwise be the largest integer such that

\[
c_i < \frac{1}{m+1}(\bar{p} + \sum_{k=1}^{i} c_k)
\]

Show that in a Nash equilibrium outcome, exactly \( m \) firms are active and they are the lowest cost firms.

**Problem 13 Hoteling competition**
The consumers are uniformly spread on \([0, 1]\), and each wants to buy one unit. Each firm charges the fixed price \( p \) and chooses its location \( s_i \) in the interval. Once locations are fixed, each consumer shops in the nearest store (the tie-breaking rule does not matter).

a) Show that with two competing stores, the unique Nash equilibrium is that both locate in the center. Is the game dominance-solvable?

b) Show that with three competing stores, the game has no Nash equilibrium.

c) What is the situation with four stores?

**Problem 14 price competition a la Hoteling**
The 1000 consumers are uniformly spread on \([0, 3]\) and each wants to buy one unit and has a very large reservation price. The two firms produce costlessly and set arbitrary prices \( s_i \). Once these prices are set consumers shop from the cheapest firm, taking into account the unit transportation cost \( t \). A consumer at distance \( d_i \) from firm \( i \) buys

from firm 1 if \( s_1 + td_1 < s_2 + td_2 \), from firm 2 if \( s_1 + td_1 > s_2 + td_2 \)

(the tie-breaking rule does not matter)

a) If the firms are located at 0 and 3, show that there is a unique Nash equilibrium pair of prices. Analyze its stability properties.

b) If the firms are located at 1 and 2, show that there is no Nash equilibrium (hint: check first that a pair of 2 different prices can’t be an equilibrium).

**Problem 15 price war**
Two duopolists (a la Bertrand) have zero marginal cost and capacity \( c \). The demand \( d \) is inelastic, with reservation price \( \bar{p} \). Assume \( c < d < 2c \). We also fix a small positive constant \( \varepsilon (\varepsilon < \frac{\bar{p}}{10}) \).

The game is defined as follows. Each firm chooses a price \( s_i, i = 1, 2 \) such that \( 0 \leq s_i \leq \bar{p} \). If \( s_i \leq s_j - \varepsilon \), firm \( i \) sells its full capacity at price \( s_i \) and firm \( j \) sells \( d - c \) at price \( s_j \). If \( |s_i - s_j| < \varepsilon \) the firms split the demand in half and sell at their own price (thus \( \varepsilon \) can be interpreted as a transportation cost between
the two firms). To sum up

\[ u_1(s) = \begin{cases} 
    cs_1 & \text{if } s_1 \leq s_2 - \varepsilon \\
    (d-c)s_1 & \text{if } s_1 \geq s_2 + \varepsilon \\
    s_1 & \text{if } s_1 - \varepsilon < s_1 < s_2 + \varepsilon 
\end{cases} \]

with a symmetric expression for firm 2.

Set \( p^* = \frac{d-c}{e}p \) and check that the best reply correspondence of firm 1 is

\[ br_1(s_2) = \begin{cases} 
    \overline{p} & \text{if } s_2 < p^* + \varepsilon \\
    \{\overline{p}, p^*\} & \text{if } s_2 = p^* + \varepsilon \\
    s_2 - \varepsilon & \text{if } s_2 > p^* + \varepsilon 
\end{cases} \]

Show that the game has no Nash equilibrium, and that the sequential best reply dynamics captures a cyclical price war.

**Problem 16 Bertrand duopoly**

The firms sell the same commodities and have the same cost function \( C(q) \), that is continuous and increasing. They compete by setting prices \( s_i, i = 1, 2 \). The demand function \( D \) is continuous and decreasing. The low price firm captures the entire demand; if the 2 prices are equal, the demand is equally split between the 2 firms. Hence the profit function for firm 1

\[ u_1(s) = \begin{cases} 
    s_1D(s_1) - C(D(s_1)) & \text{if } s_1 < s_2; = 0 & \text{if } s_1 > s_2 \\
    \frac{1}{2}s_1D(s_1) - C\left(\frac{D(s_1)}{2}\right) & \text{if } s_1 = s_2 
\end{cases} \]

and the symmetrical formula for firm 2.

a) Show that if \( s^* \) is a Nash equilibrium, then \( s_1^* = s_2^* = p \) and

\[ AC\left(\frac{q}{2}\right) \leq p \leq 2AC(q) - AC\left(\frac{q}{2}\right) \]

where \( q = D(p) \) and \( AC(q) = \frac{C(q)}{q} \) is the average cost function.

b) Assume increasing returns to scale, namely \( AC \) is (strictly) decreasing. Show there is no Nash equilibrium \( s^* = (p, p) \) where the corresponding production \( q \) is positive. Find conditions on \( D \) and \( AC \) such that there is an equilibrium with \( q = 0 \).

c) In this and the next question assume decreasing returns to scale, i.e., \( AC \) is (strictly) increasing. Show that if \( s^* = (p, p) \) is a Nash equilibrium, then \( p_- \leq p \leq p_+ \) where \( p_- \) and \( p_+ \) are solutions of

\[ p_- = AC\left(\frac{D(p_-)}{2}\right) \quad \text{and} \quad p_+ = 2AC(D(p_+)) - AC\left(\frac{D(p_+)}{2}\right) \]

Check that the firms have zero profit at \( (p_-, p_-) \) but make a positive profit at \( (p_+, p_+) \) if \( p_- < p_+ \). Hint: draw on the same figure the graphs of \( D^{-1}(q) \), \( AC\left(\frac{q}{2}\right) \) and \( 2AC(q) - AC\left(\frac{q}{2}\right) \).
d) To prove that the pair \((p_+, p_+)\) found in question c) really is an equilibrium we must check that the revenue function \(R(p) = pD(p) - C(D(p))\) is non decreasing on \([0, p_+]\). In particular \(p_+\) should not be larger than the monopoly price.

Assume \(C(q) = q^2\), \(D(p) = (\alpha - \beta p)_+\) and compute the set of Nash equilibrium outcomes, discussing according to the parameters \(\alpha, \beta\).

**Problem 17** single crossing property (SCP)

Games exhibiting the SCP generalize games with non decreasing best reply functions (section 2.1.3). Assume strategy sets are real intervals \(S_i = [a_i, b_i]\) and payoff functions \(u_i\) are continuous. We say that \(u_i\) exhibit the SCP if for all \(i\) and all \(s, s' \in S_N\) such that \(s \leq s'\) we have

\[
\begin{align*}
&u_i(s'_i, s_{-i}) > u_i(s_i, s_{-i}) \Rightarrow u_i(s'_i, s'_{-i}) > u_i(s_i, s'_{-i}) \\
&u_i(s'_i, s_{-i}) \geq u_i(s_i, s_{-i}) \Rightarrow u_i(s'_i, s'_{-i}) \geq u_i(s_i, s'_{-i})
\end{align*}
\]  

(1)

a) Define \(br^-_i\) and \(br^+_i\) to be respectively the smallest and largest element of the best reply correspondence. Show that they are both non-decreasing. Define the sequences \(s'_-\) and \(s'_+\) as follows

\[
\begin{align*}
s'_- &= a; s'_{-i} = br^-_i(s'_{-i}); s'_+ = b; s'_{+i} = br^+_i(s'_{+i})
\end{align*}
\]

Show that \(s'_-\) is non decreasing while \(s'_+\) is non increasing. And that they converge respectively to the smallest equilibrium \(s_-\) and to the largest one \(s_+\). Check that the successive elimination of strictly dominated strategies converges to \([s_-, s^+]\). Thus Proposition 30 is essentially preserved for games with the SCP.

b) Show that if \(u_i\) is twice differentiable the SCP holds if and only if

\[
\frac{\partial^2 u_i}{\partial s_i \partial s_j} \geq 0 \text{ on } [a, b].
\]

c) Show that the search game (example 10) has the SCP without making any assumption on \(c_i\).

**Problem 18**

In the game \(G = (N, S_i, u_i, i \in N)\) we write

\[
\begin{align*}
\alpha_i &= \max_{s_i, s_{-i}} \min u_i(s_i, s_{-i}); \beta_i &= \min_{s_i, s_{-i}} \max u_i(s_i, s_{-i})
\end{align*}
\]

and assume the existence for each player of a prudent strategy \(\overline{s}_i\), namely \(\alpha_i = \min_{s_{-i}} u_i(\overline{s}_i, s_{-i})\).

a) Assume \(\alpha = (\alpha_i)_{i \in N}\) is a Pareto optimal utility profile: there exists \(\overline{s} \in S_N\) such that

\[
\alpha = u(\overline{s}) \text{ and for all } s \in S_N : \{u(s) \geq u(\overline{s})\} \Rightarrow u(s) = u(\overline{s})
\]

Show that \(\alpha = \beta\) and that any profile of prudent strategies is a Nash equilibrium.

b) Assume that the strategy sets \(S_i\) are all finite, and \(\beta = (\beta_i)_{i \in N}\) is a Pareto optimal utility profile. Show that if each function \(u_i\) is one-to-one on \(S_N\) then the outcome \(\overline{s}\) such that \(\beta = u(\overline{s})\) is a Nash equilibrium. Give an example of a game with finite strategy sets (where payoffs are not one-to-one) such that \(\beta\) is Pareto optimal and yet the game has no Nash equilibrium.