Dynamic Games with Incomplete Information (continued)

Peter Cramton

Takeover Game

- Target’s value $v$ is uniform on $[0,100]$
- Target knows value; Acquirer does not
- Acquirer’s value is $1.5v$
- What offer $p$ should Acquirer make to Target? This is take-it-or-leave-it bargaining game.
Auctions

- Auctions are important institutions.
- Understanding auctions should help us understand the formation of markets by modeling the competition on one side of the market.
- Auctions represent an excellent application of game theory, since in an auction the rules of the game are made explicit.

Simple Auctions

Auctions typically take one of four simple forms:

- **Oral**
  - English (↑ price)
  - Dutch (↓ price)

- **Sealed Bid**
  - 2nd Price
  - ≡ 1st Price
Simple Auctions

- **English**: price increases until only one bidder is left; the remaining bidder gets the good and pays the highest bid.
- **Dutch**: prices decreases until a bidder accepts the price; this bidder gets the good and pays the price at acceptance.
- **Second Price**: each bidder submits a bid in a sealed envelope; the highest bidder gets the good and pays the second highest bid.
- **First Price**: each bidder submits a bid in a sealed envelope; the highest bidder gets the good and pays the amount of his bid.

Auction Exercise

- Bid for single object
- Common value = $1 per bean
- On slip of paper write:
  - Name
  - Estimate (# of beans × $1)
  - Bid in first-price sealed-bid auction
  - Bid in second-price sealed-bid auction
Models of Private Information

(1) Independent Private Value:
\[ v_i \sim F_i \text{ independently of } v_j \text{ for } j \neq i. \]

(2) Common Value:
\[ e_i = v + \varepsilon_i, \varepsilon_i \sim F_i \text{ w/ mean 0}. \]

(3) Affiliated Value:
\[ v_i(x,s), \text{ my value depends on private information } x = (x_1,\ldots,x_n) \text{ and state of world } s. \]

Winner's Curse

I won. Therefore, I overestimated the most. My bid only matters when I win, so I should condition my bid on winning (i.e., that I overestimated the most).

- Winning is bad news about my estimate of value. This is a form of adverse selection that arises in any exchange setting: if you want to trade with me, it must be that no one else offered more, because they did not think that the item is worth what I am willing to pay.
Models of Private Information

• Independent private value model: It makes sense if differences in value arise from heterogeneous preferences over the attributes of the item
• Common Value: It makes sense if the bidders have homogeneous preferences, so they value the item the same ex post, but have different estimates of this true value.
• Affiliated value model: In this model, each bidder has private information that is positively correlated with the bidder's value of the good.

Auction Multiple Items

• 2 bidders (L and S), 2 identical items
• L has a value of $100 for 1 and $200 for both
• S has a value of $90 for 1 and $180 for both
• Uniform-price auction
  – Submit bid for each item
  – Highest 2 bids get items
  – 3rd highest bid determines price paid
• Ascending clock auction
  – Price starts at 0 and increases in small increments
  – Bidders express how many they want at current price
  – Bidders can only lower quantity as price rises
  – Auction ends when no excess demand (i.e. just two demanded); winners pay clock price
What if private information?

- 2 bidders (L and S), 2 identical items
- L has constant marginal value \( u \) drawn \( U[0,1] \)
- S has constant marginal value \( v \) drawn \( U[0,1] \)
- Uniform-price auction
  - Submit bid for each item
  - Highest 2 bids get items
  - 3\(^{rd}\) highest bid determines price paid
- Ascending clock auction
  - Price starts at 0 and increases in small increments
  - Bidders express how many they want at current price
  - Bidders can only lower quantity as price rises
  - Auction ends when no excess demand (i.e. just two demanded); winners pay clock price