
Contents

Preface	<i>xv</i>
1 Probability Theory	1
1.1 Basic Set Theory and Mathematical Notation	1
1.2 Probability Spaces	2
1.3 De Morgan's Laws	3
1.4 Interocitors	3
1.5 The Direct Evaluation of Probabilities	3
1.6 Probability as Frequency	4
1.7 Craps	5
1.8 A Marksman Contest	5
1.9 Sampling	5
1.10 Aces Up	6
1.11 Permutations	6
1.12 Combinations and Sampling	7
1.13 Mechanical Defects	7
1.14 Mass Defection	7
1.15 House Rules	7
1.16 The Addition Rule for Probabilities	8
1.17 A Guessing Game	8
1.18 North Island, South Island	8
1.19 Conditional Probability	9
1.20 Bayes' Rule	9
1.21 Extrasensory Perception	10
1.22 Les Cinq Tiroirs	10
1.23 Drug Testing	10
1.24 Color Blindness	11
1.25 Urns	11
1.26 The Monty Hall Game	11
1.27 The Logic of Murder and Abuse	11
1.28 The Principle of Insufficient Reason	12
1.29 The Greens and the Blacks	12
1.30 The Brain and Kidney Problem	12
1.31 The Value of Eyewitness Testimony	13

1.32	When Weakness Is Strength	13
1.33	The Uniform Distribution	16
1.34	Laplace's Law of Succession	17
1.35	From Uniform to Exponential	17
2	Bayesian Decision Theory	18
2.1	The Rational Actor Model	18
2.2	Time Consistency and Exponential Discounting	20
2.3	The Expected Utility Principle	22
2.4	Risk and the Shape of the Utility Function	26
2.5	The Scientific Status of the Rational Actor Model	30
3	Game Theory: Basic Concepts	32
3.1	Big John and Little John	32
3.2	The Extensive Form	38
3.3	The Normal Form	41
3.4	Mixed Strategies	42
3.5	Nash Equilibrium	43
3.6	The Fundamental Theorem of Game Theory	44
3.7	Solving for Mixed-Strategy Nash Equilibria	45
3.8	Throwing Fingers	46
3.9	Battle of the Sexes	46
3.10	The Hawk-Dove Game	48
3.11	The Prisoner's Dilemma	50
4	Eliminating Dominated Strategies	52
4.1	Dominated Strategies	52
4.2	Backward Induction	54
4.3	Exercises in Eliminating Dominated Strategies	55
4.4	Subgame Perfection	57
4.5	Stackelberg Leadership	59
4.6	The Second-Price Auction	59
4.7	The Mystery of Kidnapping	60
4.8	The Eviction Notice	62
4.9	Hagar's Battles	62
4.10	Military Strategy	63
4.11	The Dr. Strangelove Game	64

4.12	Strategic Voting	64
4.13	Nuisance Suits	65
4.14	An Armaments Game	67
4.15	Football Strategy	67
4.16	Poker with Bluffing	68
4.17	The Little Miss Muffet Game	69
4.18	Cooperation with Overlapping Generations	70
4.19	Dominance-Solvable Games	71
4.20	Agent-based Modeling	72
4.21	Why Play a Nash Equilibrium?	75
4.22	Modeling the Finitely-Repeated Prisoner's Dilemma	77
4.23	Review of Basic Concepts	79
5	Pure-Strategy Nash Equilibria	80
5.1	Price Matching as Tacit Collusion	80
5.2	Competition on Main Street	81
5.3	Markets as Disciplining Devices: Allied Widgets	81
5.4	The Tobacco Market	87
5.5	The Klingons and the Snarks	87
5.6	Chess: The Trivial Pastime	88
5.7	No-Draw, High-Low Poker	89
5.8	An Agent-based Model of No-Draw, High-Low Poker	91
5.9	The Truth Game	92
5.10	The Rubinstein Bargaining Model	94
5.11	Bargaining with Heterogeneous Impatience	96
5.12	Bargaining with One Outside Option	97
5.13	Bargaining with Dual Outside Options	98
5.14	Huey, Dewey, and Louie Split a Dollar	102
5.15	Twin Sisters	104
5.16	The Samaritan's Dilemma	104
5.17	The Rotten Kid Theorem	106
5.18	The Shopper and the Fish Merchant	107
5.19	Pure Coordination Games	109
5.20	Pick Any Number	109
5.21	Pure Coordination Games: Experimental Evidence	110
5.22	Introductory Offers	111
5.23	Web Sites (for Spiders)	112

6	Mixed-Strategy Nash Equilibria	116
6.1	The Algebra of Mixed Strategies	116
6.2	Lions and Antelope	117
6.3	A Patent Race	118
6.4	Tennis Strategy	119
6.5	Preservation of Ecology Game	119
6.6	Hard Love	120
6.7	Advertising Game	120
6.8	Robin Hood and Little John	122
6.9	The Motorist's Dilemma	122
6.10	Family Politics	123
6.11	Frankie and Johnny	123
6.12	A Card Game	124
6.13	Cheater-Inspector	126
6.14	The Vindication of the Hawk	126
6.15	Characterizing 2×2 Normal Form Games I	127
6.16	Big John and Little John Revisited	128
6.17	Dominance Revisited	128
6.18	Competition on Main Street Revisited	128
6.19	Twin Sisters Revisited	129
6.20	Twin Sisters: An Agent-Based Model	129
6.21	One-Card, Two-Round Poker with Bluffing	131
6.22	An Agent-Based Model of Poker with Bluffing	132
6.23	Trust in Networks	133
6.24	El Farol	134
6.25	Decorated Lizards	135
6.26	Sex Ratios as Nash Equilibria	137
6.27	A Mating Game	140
6.28	Coordination Failure	141
6.29	Colonel Blotto Game	141
6.30	Number Guessing Game	142
6.31	Target Selection	142
6.32	A Reconnaissance Game	142
6.33	Attack on Hidden Object	143
6.34	Two-Person, Zero-Sum Games	143
6.35	Mutual Monitoring in a Partnership	145
6.36	Mutual Monitoring in Teams	145

6.37	Altruism(?) in Bird Flocks	146
6.38	The Groucho Marx Game	147
6.39	Games of Perfect Information	151
6.40	Correlated Equilibria	151
6.41	Territoriality as a Correlated Equilibrium	153
6.42	Haggling at the Bazaar	154
6.43	Poker with Bluffing Revisited	156
6.44	Algorithms for Finding Nash Equilibria	157
6.45	Why Play Mixed Strategies?	160
6.46	Reviewing of Basic Concepts	161
7	Principal-Agent Models	162
7.1	Gift Exchange	162
7.2	Contract Monitoring	163
7.3	Profit Signaling	164
7.4	Properties of the Employment Relationship	168
7.5	Peasant and Landlord	169
7.6	Bob's Car Insurance	173
7.7	A Generic Principal-Agent Model	174
8	Signaling Games	179
8.1	Signaling as a Coevolutionary Process	179
8.2	A Generic Signaling Game	180
8.3	Sex and Piety: The Darwin-Fisher Model	182
8.4	Biological Signals as Handicaps	187
8.5	The Shepherds Who Never Cry Wolf	189
8.6	My Brother's Keeper	190
8.7	Honest Signaling among Partial Altruists	193
8.8	Educational Signaling	195
8.9	Education as a Screening Device	197
8.10	Capital as a Signaling Device	199
9	Repeated Games	201
9.1	Death and Discount Rates in Repeated Games	202
9.2	Big Fish and Little Fish	202
9.3	Alice and Bob Cooperate	204
9.4	The Strategy of an Oil Cartel	205

9.5	Reputational Equilibrium	205
9.6	Tacit Collusion	206
9.7	The One-Stage Deviation Principle	208
9.8	Tit for Tat	209
9.9	I'd Rather Switch Than Fight	210
9.10	The Folk Theorem	213
9.11	The Folk Theorem and the Nature of Signaling	216
9.12	The Folk Theorem Fails in Large Groups	217
9.13	Contingent Renewal Markets Do Not Clear	219
9.14	Short-Side Power in Contingent Renewal Markets	222
9.15	Money Confers Power in Contingent Renewal Markets	223
9.16	The Economy Is Controlled by the Wealthy	223
9.17	Contingent Renewal Labor Markets	224
10	Evolutionarily Stable Strategies	229
10.1	Evolutionarily Stable Strategies: Definition	230
10.2	Properties of Evolutionarily Stable Strategies	232
10.3	Characterizing Evolutionarily Stable Strategies	233
10.4	A Symmetric Coordination Game	236
10.5	A Dynamic Battle of the Sexes	236
10.6	Symmetrical Throwing Fingers	237
10.7	Hawks, Doves, and Bourgeois	238
10.8	Trust in Networks II	238
10.9	Cooperative Fishing	238
10.10	Evolutionarily Stable Strategies Are Not Unbeatable	240
10.11	A Nash Equilibrium That Is Not an EES	240
10.12	Rock, Paper, and Scissors Has No ESS	241
10.13	Invasion of the Pure-Strategy Mutants	241
10.14	Multiple Evolutionarily Stable Strategies	242
10.15	Evolutionarily Stable Strategies in Finite Populations	242
10.16	Evolutionarily Stable Strategies in Asymmetric Games	244
11	Dynamical Systems	247
11.1	Dynamical Systems: Definition	247
11.2	Population Growth	248
11.3	Population Growth with Limited Carrying Capacity	249
11.4	The Lotka-Volterra Predator-Prey Model	251

11.5	Dynamical Systems Theory	255
11.6	Existence and Uniqueness	256
11.7	The Linearization Theorem	257
11.8	Dynamical Systems in One Dimension	258
11.9	Dynamical Systems in Two Dimensions	260
11.10	Exercises in Two-Dimensional Linear Systems	264
11.11	Lotka-Volterra with Limited Carrying Capacity	266
11.12	Take No Prisoners	266
11.13	The Hartman-Grobman Theorem	267
11.14	Features of Two-Dimensional Dynamical Systems	268
12	Evolutionary Dynamics	270
12.1	The Origins of Evolutionary Dynamics	271
12.2	Strategies as Replicators	272
12.3	A Dynamic Hawk-Dove Game	274
12.4	Sexual Reproduction and the Replicator Dynamic	276
12.5	Properties of the Replicator System	278
12.6	The Replicator Dynamic in Two Dimensions	279
12.7	Dominated Strategies and the Replicator Dynamic	280
12.8	Equilibrium and Stability with a Replicator Dynamic	282
12.9	Evolutionary Stability and Asymptotically Stability	284
12.10	Trust in Networks III	284
12.11	Characterizing 2×2 Normal Form Games II	285
12.12	Invasion of the Pure-Strategy Nash Mutants II	286
12.13	A Generalization of Rock, Paper, and Scissors	287
12.14	<i>Uta stansburiana</i> in Motion	287
12.15	The Dynamics of Rock, Paper, and Scissors	288
12.16	The Lotka-Volterra Model and Biodiversity	288
12.17	Asymmetric Evolutionary Games	290
12.18	Asymmetric Evolutionary Games II	295
12.19	The Evolution of Trust and Honesty	295
13	Markov Economies and Stochastic Dynamical Systems	297
13.1	Markov Chains	297
13.2	The Ergodic Theorem for Markov Chains	305
13.3	The Infinite Random Walk	307
13.4	The Sisyphean Markov Chain	308

13.5	Andrei Andreyevich's Two-Urn Problem	309
13.6	Solving Linear Recursion Equations	310
13.7	Good Vibrations	311
13.8	Adaptive Learning	312
13.9	The Steady State of a Markov Chain	314
13.10	Adaptive Learning II	315
13.11	Adaptive Learning with Errors	316
13.12	Stochastic Stability	317
14	Table of Symbols	319
15	Answers	321
	Sources for Problems	373
	References	375
	Index	385