Contents

Preface		x
PART I Ratio	onal Decision Making	
Chapter	1 The Single-Person Decision Problem	3
	Actions, Outcomes, and Preferences	4
	1.1.1 Preference Relations	
	1.1.2 Payoff Functions	5
	The Rational Choice Paradigm	g
	Summary	11
	Exercises	11
Chapter	2 Introducing Uncertainty and Time	14
2.1	Risk, Nature, and Random Outcomes	14
	2.1.1 Finite Outcomes and Simple Lotteries	15
	2.1.2 Simple versus Compound Lotteries	16
	2.1.3 Lotteries over Continuous Outcomes	17
2.2	Evaluating Random Outcomes	18
	2.2.1 Expected Payoff: The Finite Case	19
	2.2.2 Expected Payoff: The Continuous Case	20
	2.2.3 Caveat: It's Not Just the Order Anymore	21
	2.2.4 Risk Attitudes	22
	2.2.5 The St. Petersburg Paradox	23
	Rational Decision Making with Uncertainty	24
	2.3.1 Rationality Revisited	24
	2.3.2 Maximizing Expected Payoffs	24
	Decisions over Time	26
	2.4.1 Backward Induction	26
	2.4.2 Discounting Future Payoffs	28
	Applications	29
	2.5.1 The Value of Information	29
	2.5.2 Discounted Future Consumption	31
	Theory versus Practice	32
	Summary	33
2.8	Exercises	33

PART II Static Games of Complete Information

C	hapte	er 3	Preliminaries	43
	3.1	Norm	al-Form Games with Pure Strategies	46
			Example: The Prisoner's Dilemma	48
		3.1.2	Example: Cournot Duopoly	49
			Example: Voting on a New Agenda	49
	3.2		x Representation: Two-Player Finite Game	50
			Example: The Prisoner's Dilemma	51
			Example: Rock-Paper-Scissors	52
	3.3		on Concepts	52
		3.3.1	Assumptions and Setup	54
		3.3.2	Evaluating Solution Concepts	55
		3.3.3	Evaluating Outcomes	56
	3.4	Sumn	nary	57
	3.5	Exerc	ises	58
C	hapte	er 4	Rationality and Common Knowledge	59
	4.1		nance in Pure Strategies	59
	7.1		Dominated Strategies	59
			Dominant Strategy Equilibrium	61
			Evaluating Dominant Strategy Equilibrium	62
	4.2		ed Elimination of Strictly Dominated Pure Strategies	63
			Iterated Elimination and Common Knowledge of Rationality	63
			Example: Cournot Duopoly	65
			Evaluating IESDS	67
	4.3		s, Best Response, and Rationalizability	69
	110	4.3.1		69
			Beliefs and Best-Response Correspondences	71
			Rationalizability	73
			The Cournot Duopoly Revisited	73
			The "p-Beauty Contest"	74
		4.3.6		76
	4.4			76
	4.5		·	76
c	hapte	er 5	Pinning Down Beliefs: Nash Equilibrium	79
	5.1		Equilibrium in Pure Strategies	80
	0.1	5.1.1	Pure-Strategy Nash Equilibrium in a Matrix	81
		5.1.2	Evaluating the Nash Equilibria Solution	83
	5.2		Equilibrium: Some Classic Applications	83
	0.100	5.2.1	Two Kinds of Societies	83
		5.2.2	The Tragedy of the Commons	84
		5.2.3	Cournot Duopoly	87
		5.2.4	Bertrand Duopoly	88
		5.2.5	Political Ideology and Electoral Competition	93
	5.3	Sumn		95
	5.4	Exerc	•	95
		120000000000000000000000000000000000000	5782890	-

Cna	pter 6 Mixed Strategies	101
6	.1 Strategies, Beliefs, and Expected Payoffs	102
	6.1.1 Finite Strategy Sets	102
	6.1.2 Continuous Strategy Sets	104
	6.1.3 Beliefs and Mixed Strategies	105
	6.1.4 Expected Payoffs	105
6	.2 Mixed-Strategy Nash Equilibrium	107
	6.2.1 Example: Matching Pennies	108
	6.2.2 Example: Rock-Paper-Scissors	111
	6.2.3 Multiple Equilibria: Pure and Mixed	113
6	.3 IESDS and Rationalizability Revisited	114
6	.4 Nash's Existence Theorem	117
6	.5 Summary	123
	.6 Exercises	123
PART III	Dynamic Games of Complete Information	
Cha	pter 7 Preliminaries	129
7	.1 The Extensive-Form Game	130
	7.1.1 Game Trees	132
	7.1.2 Imperfect versus Perfect Information	136
7	.2 Strategies and Nash Equilibrium	137
	7.2.1 Pure Strategies	137
	7.2.2 Mixed versus Behavioral Strategies	139
	7.2.3 Normal-Form Representation of Extensive-Form Games	143
7	.3 Nash Equilibrium and Paths of Play	145
7	.4 Summary	147
7	.5 Exercises	147
Cha	pter 8 Credibility and Sequential Rationality	151
8	.1 Sequential Rationality and Backward Induction	152
8	.2 Subgame-Perfect Nash Equilibrium: Concept	153
8	.3 Subgame-Perfect Nash Equilibrium: Examples	159
	8.3.1 The Centipede Game	159
	8.3.2 Stackelberg Competition	160
	8.3.3 Mutually Assured Destruction	163
	8.3.4 Time-Inconsistent Preferences	166
8	.4 Summary	169
	.5 Exercises	170
Cha	pter 9 Multistage Games	175
9	.1 Preliminaries	176
	.2 Payoffs	177
	3. Strategies and Conditional Play	178
	.4 Subgame-Perfect Equilibria	180
	.5 The One-Stage Deviation Principle	184
	.6 Summary	186
	7 Exercises	186

Chapte	r 10 Repeated Games	190
10.1	Finitely Repeated Games	190
10.2	Infinitely Repeated Games	192
	10.2.1 Payoffs	193
	10.2.2 Strategies	195
10.3	Subgame-Perfect Equilibria	196
10.4	Application: Tacit Collusion	201
10.5	Sequential Interaction and Reputation	204
	10.5.1 Cooperation as Reputation	204
	10.5.2 Third-Party Institutions as Reputation Mechanisms	205
	10.5.3 Reputation Transfers without Third Parties	207
10.6	The Folk Theorem: Almost Anything Goes	209
	Summary	214
10.8	Exercises	215
Chapte	r 11 Strategic Bargaining	220
11.1	One Round of Bargaining: The Ultimatum Game	222
11.2	Finitely Many Rounds of Bargaining	224
11.3	The Infinite-Horizon Game	228
11.4	Application: Legislative Bargaining	229
	11.4.1 Closed-Rule Bargaining	230
	11.4.2 Open-Rule Bargaining	232
11.5	Summary	235
11.6	Exercises	236
PART IV St	atic Games of Incomplete Information	
Chapte	r 12 Bayesian Games	241
12.1	Strategic Representation of Bayesian Games	246
	12.1.1 Players, Actions, Information, and Preferences	246
	12.1.2 Deriving Posteriors from a Common Prior:	
	A Player's Beliefs	247
	12.1.3 Strategies and Bayesian Nash Equilibrium	249
12.2		252
	12.2.1 Teenagers and the Game of Chicken	252
	12.2.2 Study Groups	255
	Inefficient Trade and Adverse Selection	258
	Committee Voting	261 264
	Mixed Strategies Revisited: Harsanyi's Interpretation	
	Summary	266
12.7	Exercises	266
Chapte	er 13 Auctions and Competitive Bidding	070
13.1		270
	Independent Private Values	272
	13.1.1 Second-Price Sealed-Bid Auctions	272 272
	13.1.1 Second-Price Sealed-Bid Auctions 13.1.2 English Auctions	272 272 275
	13.1.1 Second-Price Sealed-Bid Auctions 13.1.2 English Auctions 13.1.3 First-Price Sealed-Bid and Dutch Auctions	272 272 275 276
	13.1.1 Second-Price Sealed-Bid Auctions 13.1.2 English Auctions	272 272 275

Contents	•	ix

	13.3	Summary	285
	13.4	Exercises	285
CI	hapte	r 14 Mechanism Design	288
	14.1		288
		14.1.1 The Players	288
		14.1.2 The Mechanism Designer	289
		14.1.3 The Mechanism Game	290
	14.2	The Revelation Principle	292
	14.3	3,000,000,000,000,000,000,000,000,000,0	295
		14.3.1 Dominant Strategy Implementation	295
	and the	14.3.2 Vickrey-Clarke-Groves Mechanisms	295
	14.4		299
	14.5	Exercises	299
PART V	Dv	namic Games of Incomplete Information	
CI	napte	N = 1 × × × × × × × × × × × × × × × × × ×	
		Incomplete Information	303
	15.1	The Problem with Subgame Perfection	303
		Perfect Bayesian Equilibrium	307
		Sequential Equilibrium	312
		Summary	314
	15.5	Exercises	314
Cl	hapte	r 16 Signaling Games	318
	16.1	Education Signaling: The MBA Game	319
	16.2	Limit Pricing and Entry Deterrence	323
		16.2.1 Separating Equilibria	324
		16.2.2 Pooling Equilibria	330
		Refinements of Perfect Bayesian Equilibrium in Signaling Games	332
		Summary	335
	16.5	Exercises	335
CI	hapte	r 17 Building a Reputation	339
	17.1	Cooperation in a Finitely Repeated Prisoner's Dilemma	339
	17.2	Driving a Tough Bargain	342
		A Reputation for Being "Nice"	349
	17.4	Summary	354
	17.5	Exercises	354
CI	hapte	r 18 Information Transmission and Cheap Talk	357
	18.1	Information Transmission: A Finite Example	358
	18.2	Information Transmission: The Continuous Case	361
		Application: Information and Legislative Organization	365
		Summary	367
	18.5	Exercises	367

Chapte	r 19	Mathematical Appendix	369
19.1	Sets an	nd Sequences	369
	19.1.1	Basic Definitions	369
	19.1.2	Basic Set Operations	370
19.2	Functi	ons	371
	19.2.1	Basic Definitions	371
	19.2.2	Continuity	372
19.3	Calcul	us and Optimization	373
		Basic Definitions	373
		Differentiation and Optimization	374
		Integration	377
19.4		bility and Random Variables	378
		Basic Definitions	378
	19.4.2	Cumulative Distribution and Density Functions	379
		Independence, Conditional Probability, and Bayes' Rule	380
		Expected Values	382
Referen	ices		385
Index			389