Lecture13

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Lecture13

Lecture 13: Game Theory // Nash equilibrium

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Examples - Continued

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Cournot Competition

- N identical firms competing on the same market

Cournot Competition

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- Marginal cost is constant and equal to c

Cournot Competition

- N identical firms competing on the same market
- Marginal cost is constant and equal to c
- Aggregate inverse demand is

$$\boxed{p = a - b\sum_{j=1}^{N} q^j}$$

$P = a - bQ$

Cournot Competition

- N identical firms competing on the same market
- Marginal cost is constant and equal to c
- Aggregate inverse demand is

$$p = a - b\sum_{j=1}^{N} q^j$$

- Benefits of firm j are:

$$\boxed{\Pi^j(q^1, \dots q^N) = \Big(\overbrace{a - b\sum_{i=1}^{N} q^i}^{P}\Big) q^j - cq^j}$$

$\to$ Costos Totales

$$\pi^j = \left(a - b\sum_{i=1}^{N} q^i\right) q^j - c q^j$$

$$\pi^j = \Big(\underbrace{a - b(q_1 + q_2 + \dots + q_N)}_{①}\Big) \underbrace{q_j}_{②} - c q_j$$

$$\frac{\partial \pi^j}{\partial q_j} = -b q_j + \big(a - b(q_1 + \dots + q_N)\big) 1 - c = 0$$

Cournot Competition

- The FOC for a given firm is:

$$\boxed{a - b\sum_{i=1}^{N} q^i - bq_j - c = 0}$$

$\to$ BUSCAR UN EQ SIMETRICO

$q_1^* = q_2^* = \dots = q_N^* = q^*$

$$a - bNq^* - bq^* - c = 0$$

$$a - bq^*(N+1) - c = 0$$

Cournot Competition

- The FOC for a given firm is:

$$a - b\sum_{i=1}^{N} q^i - bq_j - c = 0$$

- The symmetric Nash equilibrium is given by

$$\boxed{q^* = \frac{a-c}{b(N+1)}}$$

$$\to Q^* = \frac{N(a-c)}{(N+1)(b)}$$

$$P = a - bQ = a - b\left(\frac{N(a-c)}{(N+1)b}\right)$$

$$= \frac{a(N+1) - N(a-c)}{N+1}$$

$$= \boxed{\frac{a+Nc}{N+1}}$$

$$\Pi_i = \left(\underbrace{\frac{a+Nc}{N+1}}_{P} - c\right)\left(\frac{a-c}{b(N+1)}\right) \to q^*$$

$$= \left(\frac{a+Nc-c(N+1)}{N+1}\right)\left(\frac{a-c}{b(N+1)}\right) = \left(\frac{a-c}{N+1}\right)\left(\frac{a-c}{b(N+1)}\right) = \left(\frac{a-c}{N+1}\right)^2\frac{1}{b}$$

Cournot Competition

- The FOC for a given firm is:

$$a - b\sum_{i=1}^{N} q^i - bq_j - c = 0$$

- The symmetric Nash equilibrium is given by

$$q^* = \frac{a-c}{b(N+1)}$$

- Thus

$$\sum_{j=1}^{N} q^j = \frac{N(a-c)}{b(N+1)}$$

$$p = a - N\frac{a-c}{(N+1)} < a$$

$$\Pi^j = \frac{(a-c)^2}{b(N+1)^2}$$

Cournot Competition

$$\sum_{j=1}^{N} q^j = \frac{N(a-c)}{b(N+1)}$$

$$p = a - N\frac{a-c}{(N+1)} < a$$

$$\Pi^j = \frac{(a-c)^2}{b(N+1)^2}$$

- As $N \to \infty$ we get close to perfect competition

$\boxed{\text{SI } N = 1}$ $\to q^M = Q^M = \frac{a-c}{2b}$

$$P^M = \frac{a+c}{2}$$

$$\Pi^M = \frac{(a-c)^2}{4}\frac{1}{b}$$

Cournot Competition

$$\sum_{j=1}^{N} q^j = \frac{N(a-c)}{b(N+1)}$$

$$p = a - N\frac{a-c}{(N+1)} < a$$

$$\Pi^j = \frac{(a-c)^2}{\dots}$$

Cournot Competition

$$\sum_{j=1}^{N} q^j = \frac{N(a-c)}{b(N+1)}$$
$$p = a - N\frac{a-c}{(N+1)} < a$$
$$\Pi^j = \frac{(a-c)^2}{b(N+1)^2}$$

- As $N \to \infty$ we get close to perfect competition
- $N = 1$ we get the monopoly case

Lecture 13: Game Theory // Nash equilibrium

Examples - Continued
- Cournot - Revisited
- Bertrand Competition
- Bertrand Competition - Different costs
- Bertrand Competition - 3 Firms
- Hotelling and Voting Models

Bertrand Competition

- Consider the alternative model in which firms set prices
- In the monopolist's problem, there was not distinction between a quantity-setting model and a price setting
- In oligopolistic models, this distinction is very important

Bertrand Competition

- Consider two firms with the same marginal constant marginal cost of production and demand is completely inelastic
- Each firm simultaneously chooses a price $p_i \in [0, +\infty)$
- If p_1, p_2 are the chosen prices, then the utility functions of firm i is given by:

$$\pi_i(p_i, p_{-i}) = \begin{cases} 0 & \text{if } p_i > p_{-i}, \\ (p_i - c)\frac{Q(p_i)}{2} & \text{if } p_i = p_{-i}, \\ (p_i - c)Q(p_i) & \text{if } p_i < p_{-i}. \end{cases}$$

Bertrand Competition

- Assume that the marginal revenue function is strictly decreasing ($MR'(p_i) < 0$):

$$R(p_i) = p_i Q(p_i) \quad (1)$$
$$MR(p_i) = Q(p_i) + p_i Q'(p_i) \quad (2)$$
$$= Q(p_i)(1 + \varepsilon_{Q,p}(p_i)). \quad (3)$$

$$\Pi^M = \frac{(a-c)^2}{4}\frac{1}{b}$$

Si $N \to \infty$

$$q^{CP} = \frac{a-c}{b(N+1)} \to 0$$

$$Q^{CP} = \frac{N(a-c)}{(N+1)(b)} \to \frac{a+c}{b}$$

$$P^{CP} = \frac{a+Nc}{N+1} = \frac{a}{N+1} + \frac{Nc}{N+1} \to c$$

$$\Pi^M = \frac{(a-c)^2}{(N+1)^2}\frac{1}{b} \to 0$$

Img = Cmg

P_i

► Assume that the marginal revenue function is strictly decreasing ($MR'(p_i) < 0$):

$$
\begin{aligned}
R(p_i) &= p_i Q(p_i) && (1)\\
MR(p_i) &= Q(p_i) + p_i Q'(p_i) && (2)\\
&= Q(p_i)\left(1 + \varepsilon_{Q,p}(p_i)\right). && (3)
\end{aligned}
$$

Bertrand Competition

► Assume that the marginal revenue function is strictly decreasing ($MR'(p_i) < 0$):

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► Let $p^m > c \geq 0$ be the monopoly price such that $MR(p^m) = c$.

Bertrand Competition

► Assume that the marginal revenue function is strictly decreasing ($MR'(p_i) < 0$):

$$
\begin{aligned}
R(p_i) &= p_i Q(p_i) && (1)\\
MR(p_i) &= Q(p_i) + p_i Q'(p_i) && (2)\\
&= Q(p_i)\left(1 + \varepsilon_{Q,p}(p_i)\right). && (3)
\end{aligned}
$$

► Let $p^m > c \geq 0$ be the monopoly price such that $MR(p^m) = c$.

► Then

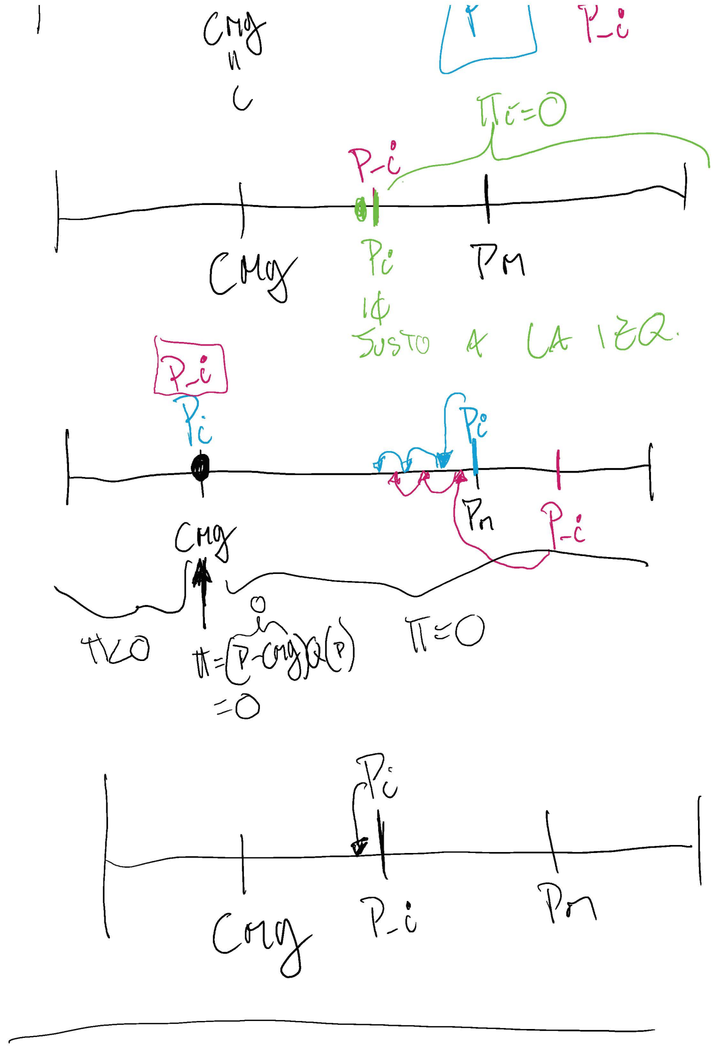
$$MR(p_i) - c > 0 \text{ if } p_i < p^m, MR(p_i) - c < 0 \text{ if } p_i > p^m.$$

Bertrand Competition

► The best response function is:

$$
BR_i(p_{-i}) = \begin{cases} p^m & \text{if } p_{-i} > p^m,\\ p_{-i} - \varepsilon & \text{if } c < p_{-i} \leq p^m,\\ [c, +\infty) & \text{if } c = p_{-i}\\ (c, +\infty) & \text{if } c > p_{-i}. \end{cases}
$$

► Where ε is the smallest monetary unit



$MR_i(P_{-i} = C) = [C, \infty)$

↳ $EN = (P_1 = C, P_2 = C)$

$\Pi_1 = 0, \Pi_2 = 0$

Bertrand Competition

Case 1: $p_1^* > p^m$

- $p_2^* = p^m$

Bertrand Competition

Case 1: $p_1^* > p^m$

- $p_2^* = p^m$
- $BR_2(p^m) = p^m - \varepsilon$

Bertrand Competition

Case 1: $p_1^* > p^m$

- $p_2^* = p^m$
- $BR_2(p^m) = p^m - \varepsilon$
- $BR_1(p^m - \varepsilon) = p^m - 2\varepsilon$

Bertrand Competition

Case 1: $p_1^* > p^m$

- $p_2^* = p^m$
- $BR_2(p^m) = p^m - \varepsilon$
- $BR_1(p^m - \varepsilon) = p^m - 2\varepsilon$
- So this cannot be a Nash equilibrium

Case 2: $p_1^* \in (c, p^m]$

- $BR_2(p_1^*) = p_1^* - \varepsilon$

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- $BR_2(p_1^*) = p_1^* - \varepsilon$
- $BR_1(p_1^* - \varepsilon) = p_1^* - 2\varepsilon$
- So this cannot be a Nash equilibrium

Case 3: $p_1^* < c$

- $BR_2(p_1^*) \in [p_1^* + \varepsilon, \infty)$

Bertrand Competition

Case 3: $p_1^* < c$

- $BR_2(p_1^*) \in [p_1^* + \varepsilon, \infty)$
- So this cannot be a Nash equilibrium

Bertrand Competition

Case 4: $p_1^* = c$

- $BR_2(p_1^*) = (c, +\infty)$

Bertrand Competition

Case 4: $p_1^* = c$

- $BR_2(p_1^*) = (c, +\infty)$
- The unique pure strategy Nash equilibrium is $p_1^* = p_2^* = c$

Bertrand Competition

Thus in contrast to the Cournot duopoly model, in the Bertrand competition model, two firms get us back to perfect competition ($p = c$)

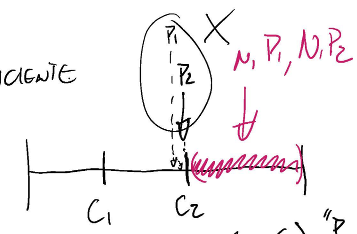
Bertrand Competition - different costs

- Suppose that the marginal cost of firm 1 is equal to c_1 and the marginal cost of firm 2 is equal to c_2 where $c_1 < c_2$.

↳ FIRMA 1 ES MAS EFICIENTE

- The best response for each firm:

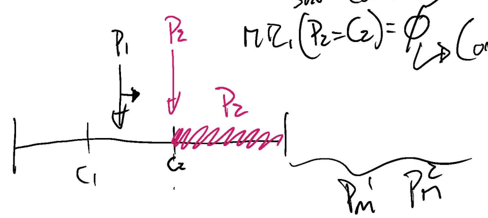
$$BR_i(p_{-i}) = \begin{cases} p_m^i & \boxed{\text{if } p_{-i} > p_m^i,} \\ p_{-i} - \varepsilon & \text{if } c_i < p_{-i} \leq p_m^i, \\ [c_i, +\infty) & \text{if } p_{-i} = c_i \\ (p_{-i}, +\infty) & \text{if } p_{-i} < c_i. \end{cases}$$



INTUITIVAMENTE $MR_1(P_2 = C_2) = \underbrace{\text{"PARARSE JUSTO A LA IZQUIERDA"}}$

NO ESTA BIEN DEFINIDO MATEMATICAMENTE PUES LOS PRECIOS SON CONTINUOS

$MR_1(P_2 = C_2) = \emptyset$ ↳ CONJUNTO VACIO.



Bertrand Competition - different costs

- If $p_2^* = p_1^* = c_1$, then firm 2 would be making a loss

Bertrand Competition - different costs

- If $p_2^* = p_1^* = c_1$, then firm 2 would be making a loss
- If $p_2^* = p_1^* = c_2$, then firm 1 would cut prices to keep the whole market

Bertrand Competition - different costs

- If $p_2^* = p_1^* = c_1$, then firm 2 would be making a loss
- If $p_2^* = p_1^* = c_2$, then firm 1 would cut prices to keep the whole market
- Any pure strategy NE must have $p_2^* \leq c_1$. Otherwise, if $p_2^* > c_1$ then firm 1 could undercut p_2^* and get a positive profit

Bertrand Competition - different costs

- If $p_2^* = p_1^* = c_1$, then firm 2 would be making a loss
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- Firm 1 would really like to price at some price p_1^* just below the marginal cost of firm 2, but wherever p_2 is set, Firm 1 would try to increase prices

Bertrand Competition - different costs

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- If $p_2^* = p_1^* = c_2$, then firm 1 would cut prices to keep the whole market
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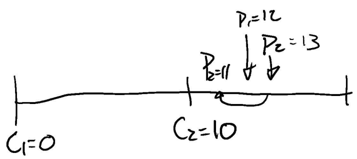
- Firm 1 would really like to price at some price p_1^* just below the marginal cost of firm 2, but wherever p_2 is set, Firm 1 would try to increase prices

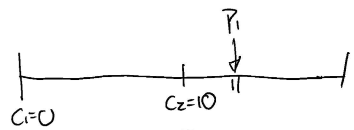
- No NE because of continuous prices

Bertrand Competition - discreet prices

$P_i \in \mathbb{N}_+$

- Suppose $c_1 = 0 < c_2 = 10$





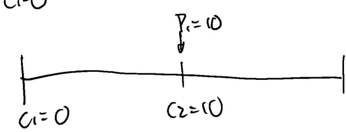
$\Rightarrow MR_2(P_1=11)=11$

$MR_1(P_2=11)=10$

No es E.N

$(11, 11)$

Uno se quiere desviar a cobrar 10



- $MR_2(P_1=10) = \boxed{[10, \infty)}$

$MR_1(P_2 \geq 11) = P_2 - 1$

$\boxed{EN = (10, 11)}$

$EN = (10,10)$?

Firma 1 tiene incentivos a desviarse

Bertrand Competition - discreet prices

- Suppose $c_1 = 0 < c_2 = 10$

$P_1=9$ $P_2=10$

$MR_2(P_1=9) = [10, \infty)$

- Suppose $c_1 = 0 < c_2 = 10$
- Firms can only set integer prices.

Bertrand Competition - discreet prices

- Suppose $c_1 = 0 < c_2 = 10$
- Firms can only set integer prices.
- Suppose that (p_1^*, p_2^*) is a pure strategy Nash equilibrium...

Bertrand Competition - discreet prices

Case 1: $p_1^* = 0$

- Best response of firm 2 is to choose some $p_2^* > p_1^*$

Bertrand Competition - discreet prices

Case 1: $p_1^* = 0$

- Best response of firm 2 is to choose some $p_2^* > p_1^*$
- p_1^* cannot be a best response to p_2^* since by setting $p_1 = p_2^*$ firm 1 would get strictly positive profits

Bertrand Competition - discreet prices

Case 2: $p_1^* \in \{1, 2, \ldots, 9\}$

- Best response of firm 2 is to set any price $p_2^* > p_1^*$

$EN = (10, \underline{11})$

$EN = (10, 10)$ ó

$\hookrightarrow$ FIRMA 1 TIENE INCENTIVOS A DESVIARSE

$p_1=9$, $p_2=10$; $c_1=0$, $c_2=10$

$MR_2(p_1=9) = [10, \infty)$

$MR_1(p_2=10) = 9$

$\boxed{EN = (9, 10)}$

$p_1=8$, $p_2=9$; $C_1=0$, $C_2=10$

$MR_2(p_1=8) = [9, \infty)$

$MR_1(p_2=9) = 8$

$EN = (8, 9)$

$EN = (7, 8)$

$EN = (6, 7)$

$EN = (5, 6)$

$EN = (4, 5)$

$EN = (3, 4)$

$EN = (2, 3)$

$EN = (1, 2)$

$p_1=1$, $p_2=2$; $C_1=0$, $C_1=10$

$MR_2(p_1=1) = [2, \infty)$

$MR_1(p_2=2) = 1$

$p_1=0 \rightarrow$ TIENE INCENTIVOS A DESVIARSE

$p_2=1$; $C_1=0$, $C_1=10$

~~$EN = (0, 1)$~~

~~$EN = (1, 1)$~~

~~$EN = (0, 0)$~~ $\hookrightarrow$ FIRMA 2 INCENTIVOS A MOVERSE

$EN = \{(10, \underline{11}), (9, 10), (8, 9), \ldots, (1, 2)\}$

~~$EN = (14, 15)$~~

~~$C_1=0$, $C_1=10$, 13, 14, 15~~

$c_1 = 0$

$c_1 = 10$ 15 14 15

Bertrand Competition - discreet prices

Case 2: $p_1^* \in \{1, 2, \ldots, 9\}$

- Best response of firm 2 is to set any price $p_2^* > p_1^*$
- If $p_2^* > p_1^* + 1$, then this cannot be a Nash equilibrium since then firm 1 would have an incentive to raise the price

Bertrand Competition - discreet prices

Case 2: $p_1^* \in \{1, 2, \ldots, 9\}$

- Best response of firm 2 is to set any price $p_2^* > p_1^*$
- If $p_2^* > p_1^* + 1$, then this cannot be a Nash equilibrium since then firm 1 would have an incentive to raise the price

- The only equilibrium is $(p_1^*, p_1^* + 1)$

Bertrand Competition - discreet prices

Case 3: $p_1^* = 10$

- Best responses of firm 2 is to set any price $p_2^* \geq p_1^*$

Bertrand Competition - discreet prices

Case 3: $p_1^* = 10$

- Best responses of firm 2 is to set any price $p_2^* \geq p_1^*$

- It cannot be that $p_2^* = p_1^*$ since then firm 1 would rather deviate to a price of 9 and control the whole market:

$$\frac{1}{2}(10) = 5 < 9.$$

Bertrand Competition - discreet prices

Case 3: $p_1^* = 10$

- Best responses of firm 2 is to set any price $p_2^* \geq p_1^*$
- It cannot be that $p_2^* = p_1^*$ since then firm 1 would rather deviate to a price of 9 and control the whole market:

$$\frac{1}{2}(10) = 5 < 9.$$

- We must have $p_2^* = p_1^* + 1$ since otherwise, firm 1 would have an incentive to raise the price higher

Bertrand Competition - discreet prices

Case 3: $p_1^* = 10$

- Best responses of firm 2 is to set any price $p_2^* \geq p_1^*$
- It cannot be that $p_2^* = p_1^*$ since then firm 1 would rather deviate to a price of 9 and control the whole market:

$$\frac{1}{2}(10) = 5 < 9.$$

- We must have $p_2^* = p_1^* + 1$ since otherwise, firm 1 would have an incentive to raise the price higher
- $(p_1^*, p_2^*) = (10, 11)$ is a Nash equilibrium

Bertrand Competition - discreet prices

Case 4: $p_1^* = 11$

- Best response of firm 2 is to set $p_2^* = 11$

Bertrand Competition - discreet prices

Case 4: $p_1^* = 11$

- Best response of firm 2 is to set $p_2^* = 11$
- Firm 1 would not be best responding since by setting a price of $p_1 = 10$, it would get strictly positive profits

Bertrand Competition - discreet prices

Case 5: $p_1^* \geq 12$

- Firm 2's best response is to set either $p_2^* = p_1^* - 1$ or $p_2^* = p_1^*$

Bertrand Competition - discreet prices

Case 5: $p_1^* \geq 12$

- Firm 2's best response is to set either $p_2^* = p_1^* - 1$ or $p_2^* = p_1^*$

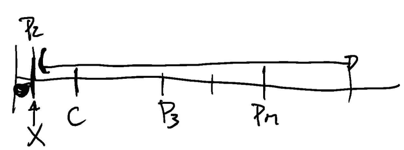
- Firm 1 is not best responding since by lowering the price it can get the whole market.

Lecture 13: Game Theory // Nash equilibrium

Examples - Continued
- Cournot - Revisited
- Bertrand Competition
- Bertrand Competition - Different costs
- Bertrand Competition - 3 Firms
- Hotelling and Voting Models

Bertrand Competition - 3 firms

- Symmetric marginal costs model but with 3 firms → Mismo Costo 3 Firmas



Bertrand Competition - 3 firms

- Symmetric marginal costs model but with 3 firms
- Best response of firm i is given by:

$$BR_1(p_2,p_3) = \begin{cases} p^m & \text{if } \min\{p_2,p_3\} > p^m, \\ \min\{p_2,p_3\} - \varepsilon & \text{if } c < \min\{p_2,p_3\} \le p^m, \\ [c, +\infty) & \text{if } c = \min\{p_2,p_3\}, \\ (\min\{p_2,p_3\}, +\infty) & \text{if } c > \min\{p_2,p_3\}. \end{cases}$$

Bertrand Competition - 3 firms

- Symmetric marginal costs model but with 3 firms
- Best response of firm i is given by:

$$BR_1(p_2,p_3) = \begin{cases} p^m & \text{if } \min\{p_2,p_3\} > p^m, \\ \min\{p_2,p_3\} - \varepsilon & \text{if } c < \min\{p_2,p_3\} \le p^m, \\ [c, +\infty) & \text{if } c = \min\{p_2,p_3\}, \\ (\min\{p_2,p_3\}, +\infty) & \text{if } c > \min\{p_2,p_3\}. \end{cases}$$

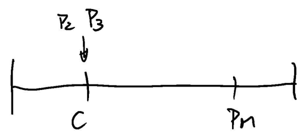
- (c,c,c) is indeed a pure strategy Nash equilibrium as in the two firm case

Bertrand Competition - 3 firms

- If (p_1,p_2,p_3) was a pure strategy Nash equilibrium, it can never be the case that $\min\{p_1,p_2,p_3\} < c$

Bertrand Competition - 3 firms

- If (p_1,p_2,p_3) was a pure strategy Nash equilibrium, it can never be the case that $\min\{p_1,p_2,p_3\} < c$
- If (p_1,p_2,p_3) was a pure strategy Nash equilibrium, it can never be the case that $\min\{p_1,p_2,p_3\} > c$



$MR_1(P_2=P_3=C) = [C, \infty]$

$MR_2(P_1=P_3=C) = [C, \infty]$

$MR_3(P_2=P_3=C) = [C, \infty]$

$MIN(P_1,P_2,P_3) > C$

NO PUDE SER E.N.

$MIN(P_1,P_2,P_3) < C$

NO PUED SER EN.

$MIN(P_1,P_2,P_3) = C$

$\boxed{P_1=P_2=P_3=C}$ ✓ E.N.

$\cancel{P_i=C,\ P_j>C,\ P_k>C}$ ~~E.N.~~

i TIENE INCENTIVOS A MOVERSE

$P_i=C,\ P_j=C,\ P_k>C$ — EN ✓

$P_i=C,\ P_j=C$: TAMPOCO TIENEN INCENTIVOS A MOVERSE

$P_k>C$: NO TIENE INCENTIVOS

Bertrand Competition - 3 firms

- If (p_1, p_2, p_3) was a pure strategy Nash equilibrium, it can never be the case that $\min\{p_1, p_2, p_3\} < c$
- If (p_1, p_2, p_3) was a pure strategy Nash equilibrium, it can never be the case that $\min\{p_1, p_2, p_3\} > c$
- We must have $\min\{p_1, p_2, p_3\} = c$

Bertrand Competition - 3 firms

- If (p_1, p_2, p_3) was a pure strategy Nash equilibrium, it can never be the case that $\min\{p_1, p_2, p_3\} < c$
- If (p_1, p_2, p_3) was a pure strategy Nash equilibrium, it can never be the case that $\min\{p_1, p_2, p_3\} > c$
- We must have $\min\{p_1, p_2, p_3\} = c$
- Can there be a pure strategy Nash equilibrium in which just one firm sets price equal to c?

Bertrand Competition - 3 firms

- If (p_1, p_2, p_3) was a pure strategy Nash equilibrium, it can never be the case that $\min\{p_1, p_2, p_3\} < c$
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- Set of all pure strategy Nash equilibria are given by:

$$\{(c, c, c+\varepsilon) : \varepsilon \geq 0\} \cup \{(c, c+\varepsilon, c) : \varepsilon \geq 0\} \cup \{(c+\varepsilon, c, c) : \varepsilon \geq 0\}.$$

Lecture 13: Game Theory // Nash equilibrium

Hotelling

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Hotelling

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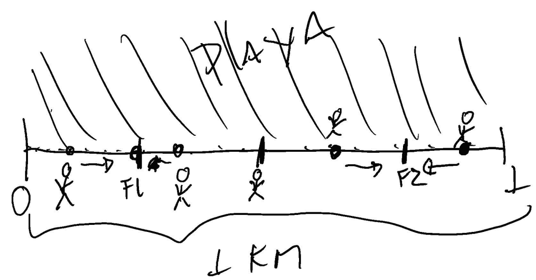

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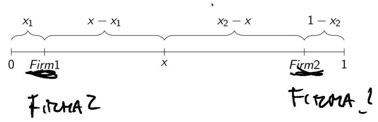
- If the firms $i = 1, 2$ respectively produce products of characteristic x_1 and x_2, then a consumer at θ would consume whichever product is closest to θ
- The game consists of the two players $i = 1, 2$, each of whom chooses a point $x_1, x_2 \in [0, 1]$ simultaneously.

Hotelling



$$\boxed{U_1 = X = \frac{X_1 + X_2}{2}}$$

$$\boxed{U_2 = 1 - X = 1 - \left(\frac{X_1 + X_2}{2}\right)}$$

$$\boxed{\boxed{X - X_1} = \boxed{X_2 - X}}$$

$$\to 2X = X_1 + X_2$$

$$X = X_1 + X_2$$

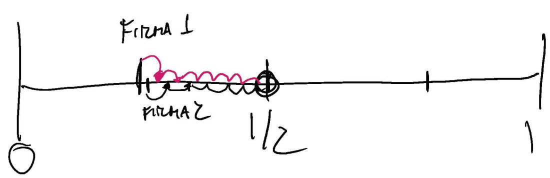
Hotelling

Then the profits that accrue to firm 1 is given by the mass of consumers that are closest to firm 1:

$$u_1(x_1, x_2) = \begin{cases} \frac{x_1 + x_2}{2} & \text{if } x_1 < x_2, \\ \frac{1}{2} & \text{if } x_1 = x_2, \\ 1 - \frac{x_1 + x_2}{2} & \text{if } x_1 > x_2. \end{cases}$$

Similarly,

$$u_2(x_1, x_2) = \begin{cases} 1 - \frac{x_1 + x_2}{2} & \text{if } x_1 < x_2, \\ \frac{1}{2} & \text{if } x_1 = x_2, \\ \frac{x_1 + x_2}{2} & \text{if } x_1 > x_2. \end{cases}$$



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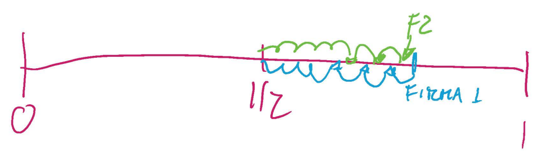

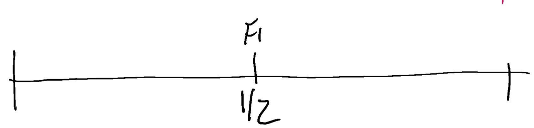

$$\boxed{EN = \left(\tfrac{1}{2}, \tfrac{1}{2}\right)}$$

NO CONCUERDA CON LA REALIDAD.

Hotelling

Compute the best response functions

- **Case 1:** Suppose first that $x_2 > 1/2$. Then setting x_1 against x_2 yields a payoff of

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- **Case 2:** Suppose next that $x_2 < 1/2$. Again there will be no best response for firm 1 (try to set as close to the right the other firm as possible)
- **Case 3:** Suppose next that $x_2 = 1/2$. Here there will be a best response for firm 1 at $1/2$

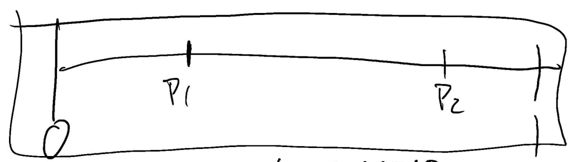
Hotelling

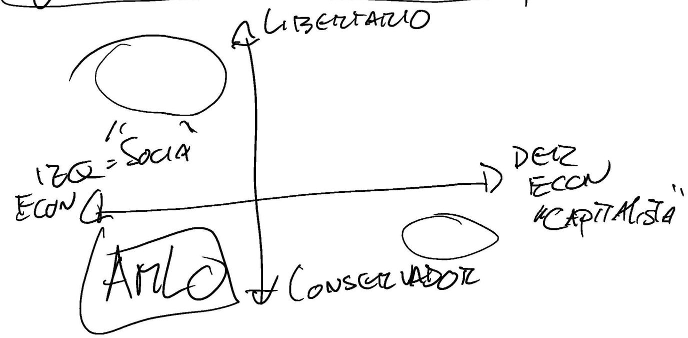
$$BR_1(x_2) = \begin{cases} \emptyset & \text{if } x_2 > 1/2 \\ 1/2 & \text{if } x_2 = 1/2 \\ \emptyset & \text{if } x_2 < 1/2. \end{cases}$$

Symmetrically, we have:

$$BR_2(x_1) = \begin{cases} \emptyset & \text{if } x_1 > 1/2 \\ 1/2 & \text{if } x_1 = 1/2 \\ \emptyset & \text{if } x_1 < 1/2. \end{cases}$$

The unique Nash equilibrium is for each firm to choose $(x_1, x_2) = (1/2, 1/2)$. Each firm essentially locates in the same place





Hotelling

- Hotelling can also be done in a discreet setting
- Hotelling can be applied to a variety of situations (e.g., voting)
- But this predicts the opposite of polarization
- With three candidates, predictions are quite different
- All candidates picking $\frac{1}{2}$ is no longer a Nash equilibrium
- What are the set of pure strategy equilibria here? (this is a difficult problem).

$\max_{s_1, s_2} U_1$ s.a $U_2 \geq U$

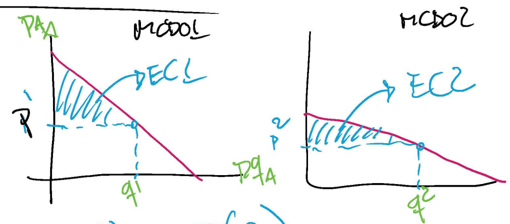
CPO

$S_1 = S_2 + 10$

$EN = (5, 3)$

$CT = Q^2$

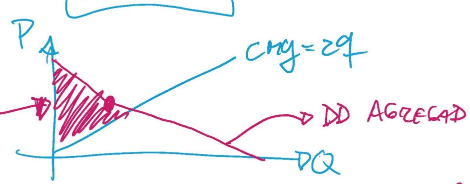
$Cmg = 2Q = 2(q_A + q_B)$



$EP = \pi = Q(P)\,P - CT(Q)$

$PBS = (EC^{CP} + EP^{CP} - EC1 - EC2 - EP)$

$CP \Rightarrow \boxed{P = Cmg}$



$C = 0$