

EPICENTER Spring Course on Epistemic Game Theory

Chapter 4: Simple Belief Hierarchies

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July 2, 2019

Simple belief hierarchies

- Previously, we have discussed the idea of **common belief in rationality**.
- So, we focus on **belief hierarchies** in which you believe that
- your opponents choose **rationally**,
- your opponents believe that their opponents choose **rationally**,
- your opponents believe that their opponents believe that their opponents choose **rationally**,
- and so on.
- Can we still **distinguish** between such belief hierarchies?
- We will look at **psychological** factors beyond common belief in rationality.

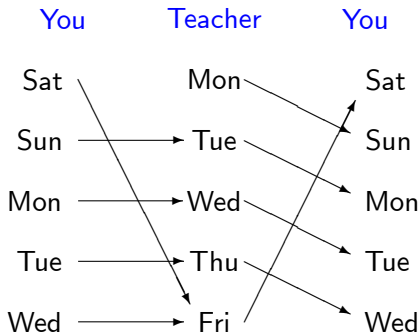
Example: Teaching a lesson

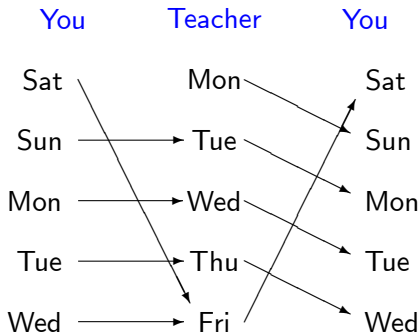
Story

- It is Friday, and your biology teacher tells you that he will give you a **surprise exam** next week.
- You must decide on what day you will start **preparing** for the exam.
- In order to **pass** the exam, you must study for **at least two days**.
- To write the **perfect exam**, you must study for **at least six days**. In that case, you will get a **compliment** by your father.
- **Passing** the exam **increases** your utility by **5**.
- **Failing** the exam **increases** the teacher's utility by **5**.
- Every day you study **decreases** your utility by **1**, but **increases** the teacher's utility by **1**.
- A **compliment** by your father **increases** your utility by **4**.

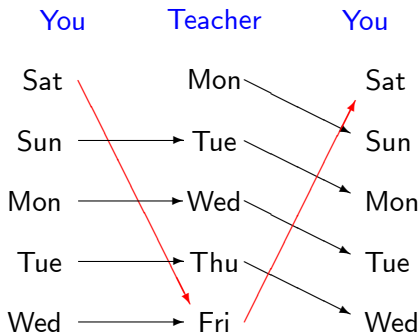
Teacher

		Mon	Tue	Wed	Thu	Fri
You	Sat	3, 2	2, 3	1, 4	0, 5	3, 6
	Sun	-1, 6	3, 2	2, 3	1, 4	0, 5
	Mon	0, 5	-1, 6	3, 2	2, 3	1, 4
	Tue	0, 5	0, 5	-1, 6	3, 2	2, 3
	Wed	0, 5	0, 5	0, 5	-1, 6	3, 2

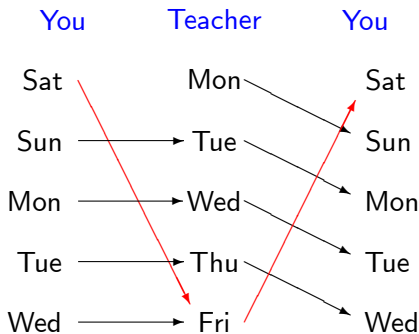




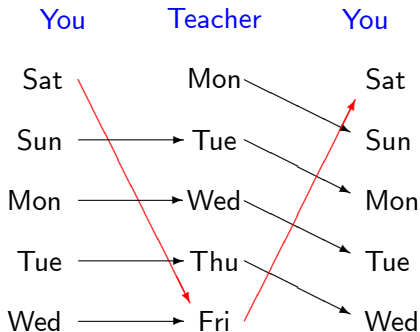
- Under **common belief in rationality**, you can rationally choose **any** day to start studying.
- Is there still a way to **distinguish** between your various choices?
- Yes! Some choices are supported by a **simple belief hierarchy**, whereas other choices are not.



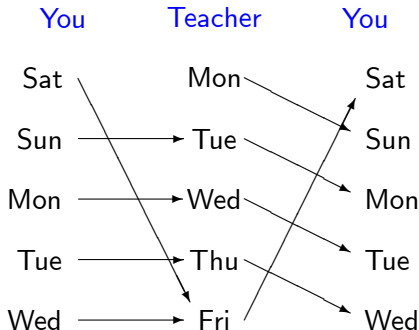
- Consider the **belief hierarchy** that supports your choices **Saturday** and **Wednesday**.
- This belief hierarchy is **entirely generated** by the belief σ_2 that the teacher puts the exam on **Friday**, and the belief σ_1 that you start studying on **Saturday**.



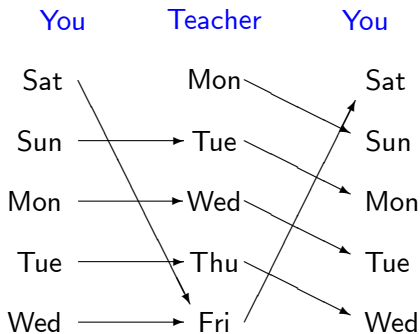
- Let σ_2 be the belief that the teacher chooses *Friday*, and let σ_1 be the belief that you choose *Saturday*.
- Then, in the *belief hierarchy* that supports your choices *Saturday* and *Wednesday*,
- your belief about the teacher's choice is σ_2 ,
- you believe, with *probability 1*, that the teacher's belief about your choice is σ_1 ,
- ...



- ... you believe, with **prob. 1**, that the teacher believes, with **prob. 1**, that your belief about the teacher's choice is **indeed σ_2** ,
- you believe, **with prob. 1**, that the teacher believes, **with prob. 1**, that you believe, **with prob. 1**, that the teacher's belief about your choice is **indeed σ_1** ,
- and so on.
- So, this belief hierarchy is **completely generated** by the beliefs σ_1 and σ_2 . We call such a belief hierarchy **simple**.



- The **belief hierarchies** that support your choices **Sunday**, **Monday** and **Tuesday** are certainly **not simple**. Consider, for instance, the **belief hierarchy** that supports your choice **Sunday**. There,
 - you believe that the teacher puts the exam on **Tuesday**,
 - but you believe that the teacher believes that you believe that the teacher will put the exam on **Wednesday**.



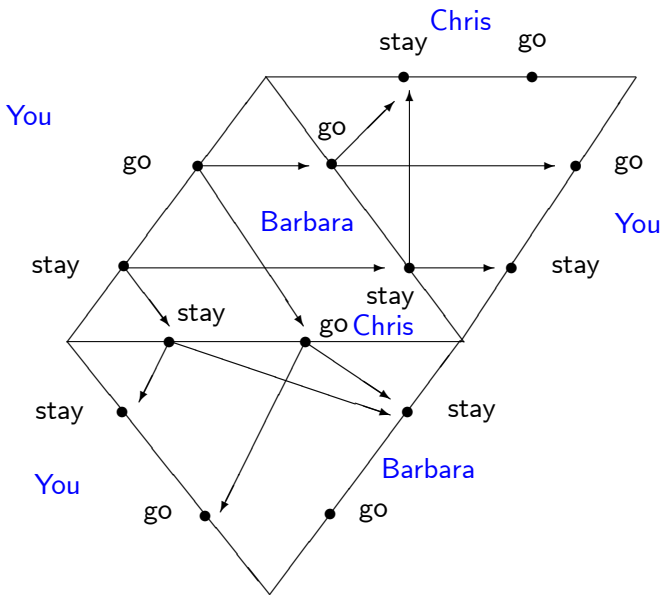
Summarizing

- Within this beliefs diagram:
- You can rationally make **every** choice under **common belief in rationality**.
- Your choices **Saturday** and **Wednesday** are supported by a **simple belief hierarchy**.
- Your other choices are supported by **non-simple belief hierarchies**.

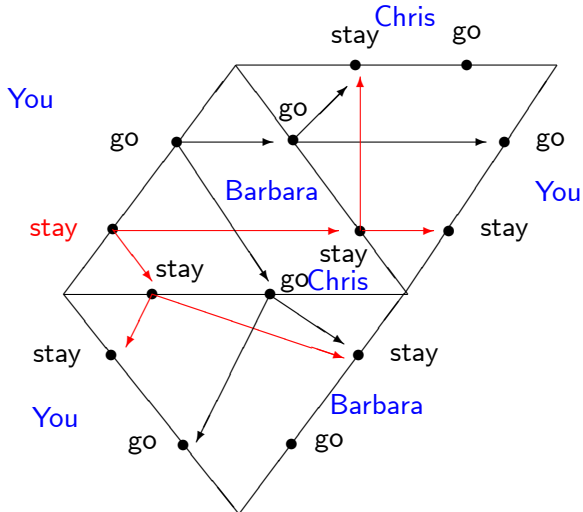
Example: Movie or party?

Story

- You have been invited to a **party** this evening, together with **Barbara** and **Chris**. But this evening, your favorite movie **Once upon a time in America**, starring Robert de Niro, will be on TV.
- Having a **good time** at the party gives you utility **3**, watching the **movie** gives you utility **2**, whereas having a **bad time** at the party gives you utility **0**. Similarly for Barbara and Chris.
- You will only have a **good time** at the party if **Barbara and Chris** both join.
- Barbara and Chris had a **fierce discussion** yesterday. Barbara will only have a **good time** at the party if **you** join, but **not Chris**.
- Chris will only have a **good time** at the party if **you** join, but **not Barbara**.
- What should you do: **Go** to the party, or **stay** at home?

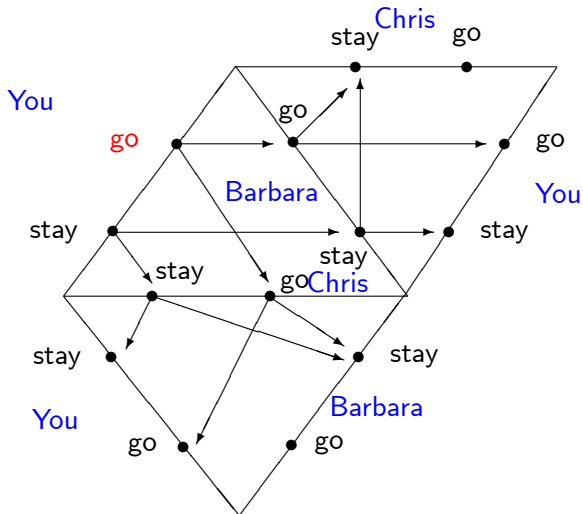


- Under **common belief in rationality**, you can **go** to the party or **stay** at home.

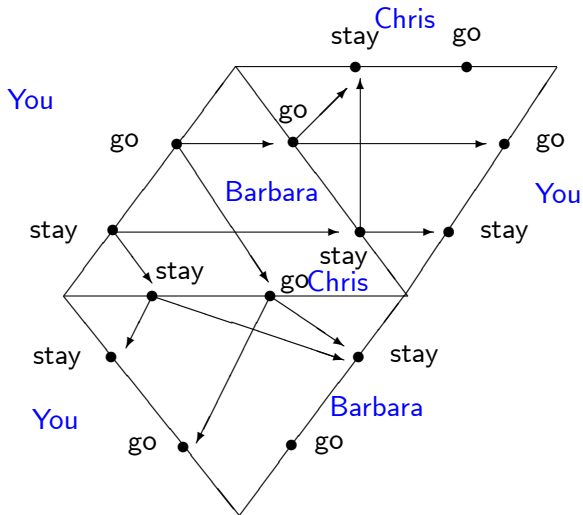


- The belief hierarchy that supports your choice **stay** is **simple**: It is completely generated by the beliefs

$$\sigma_1 = \text{You stay}, \sigma_2 = \text{Barbara stays}, \sigma_3 = \text{Chris stays}.$$



- The belief hierarchy that supports your choice go is not simple:
- You believe that Chris will go to the party.
- You believe that Barbara believes that Chris will stay at home.



- **Summarizing:** Under **common belief in rationality**, you can rationally choose **go** or **stay**.
- In this beliefs diagram, **stay** is supported by a **simple belief hierarchy**, but **go** is **not**.

- In general, a belief hierarchy is called simple if it is generated by a combination of beliefs $\sigma_1, \dots, \sigma_n$.

Definition (Belief hierarchy generated by $(\sigma_1, \dots, \sigma_n)$)

For every player i , let σ_i be a probabilistic belief about i 's choice.

The belief hierarchy for player i that is generated by $(\sigma_1, \dots, \sigma_n)$ states that


- (1) player i has belief σ_j about player j 's choice,
- (2) player i believes that player j has belief σ_k about player k 's choice,
- (3) player i believes that player j believes that player k has belief σ_l about player l 's choice,

and so on.

Definition (Simple belief hierarchy)

Consider an **epistemic model**, and a **type** t_i within it.

Type t_i has a **simple belief hierarchy**, if its belief hierarchy is **generated** by some combination of **beliefs** $(\sigma_1, \dots, \sigma_n)$.

- **Observation 1:** A type with a **simple** belief hierarchy always believes that his opponents are **correct** about his entire **belief hierarchy**.
- **Proof.** Take a type t_i with a **simple** belief hierarchy. Then, its belief hierarchy is **generated** by some combination of **beliefs** $(\sigma_1, \dots, \sigma_n)$.
- Fix an opponent j . Then, t_i has belief σ_j about j 's choice. But also, t_i believes that every opponent believes that he (player i) has **indeed** belief σ_j about j 's choice.
- Fix an opponent j , and some player $k \neq j$. Then, t_i believes that player j has belief σ_k about k 's choice. But also, t_i believes that every opponent believes that he (player i) **indeed** believes that player j has belief σ_k about k 's choice.
- And so on. 

Definition (Simple belief hierarchy)

Consider an **epistemic model**, and a **type** t_i within it.

Type t_i has a **simple belief hierarchy**, if its belief hierarchy is **generated** by some combination of **beliefs** $(\sigma_1, \dots, \sigma_n)$.

- **Observation 2:** In a game with **three players or more**, a type t_i with a **simple** belief hierarchy believes that his opponents **share his beliefs** about other players.
- **Proof.** Suppose that t_i 's belief hierarchy is **generated** by $(\sigma_1, \dots, \sigma_n)$.
- Fix two different opponents j and k . Then, t_i 's belief about k 's choice is σ_k . But t_i also believes that j has belief σ_k about k 's choice.
- Take some player $l \neq k$. Then, t_i believes that k 's belief about l 's choice is σ_l . But t_i also believes that j believes that k 's belief about l 's choice is σ_l .
- And so on. ■

Definition (Simple belief hierarchy)

Consider an **epistemic model**, and a **type** t_i within it.

Type t_i has a **simple belief hierarchy**, if its belief hierarchy is **generated** by some combination of **beliefs** $(\sigma_1, \dots, \sigma_n)$.

- **Observation 3:** In a game with **three players or more**, consider a type t_i with a **simple** belief hierarchy.

Then, player i 's belief about j 's choice is **independent** from i 's belief about k 's choice.

- Indeed, the probability that i assigns to j choosing c_j and k choosing c_k is given by the **product**

$$\sigma_j(c_j) \cdot \sigma_k(c_k).$$

- In the example **"Movie or party?"**, for instance, the belief

$$(0.5) \cdot (\textit{stay}, \textit{stay}) + (0.5) \cdot (\textit{go}, \textit{go})$$

is **not possible** in a **simple** belief hierarchy.

Definition (Simple belief hierarchy)

Consider an epistemic model, and a type t_i within it.

Type t_i has a simple belief hierarchy, if its belief hierarchy is generated by some combination of beliefs $(\sigma_1, \dots, \sigma_n)$.

- **Observation 4:** Consider a type t_i with a simple belief hierarchy, which believes in j 's rationality.

Suppose that t_i assigns a positive probability to j 's choices a and b .

Then, t_i must believe that j is indifferent between a and b .

- **Proof.** Type t_i only deems possible one belief hierarchy for player j – the simple belief hierarchy for j generated by $(\sigma_1, \dots, \sigma_n)$.
- Hence, if t_i assigns positive probability to a and b , and believes in j 's rationality, then t_i must believe that both a and b are optimal for j 's simple belief hierarchy generated by $(\sigma_1, \dots, \sigma_n)$.
- Thus, t_i must believe that j is indifferent between a and b . ■
- This is not true for non-simple belief hierarchies.

- Previously we have focused on **belief hierarchies** that express **common belief in rationality**.
- So far in this chapter, we have focused on **belief hierarchies** that are **simple**.
- Can we **characterize**, in an easy way, those **belief hierarchies** that express **common belief in rationality** and are **simple**?

- Consider a type t_i with a **simple belief hierarchy**. Then, t_i 's belief hierarchy is **generated** by some combination $(\sigma_1, \dots, \sigma_n)$ of **beliefs**. Hence:
 - t_i 's belief about the opponents' choices is σ_{-i} ,
 - t_i believes that player j 's has belief σ_{-j} about his opponents' choices,
 - t_i believes that player j believes that player k has belief σ_{-k} about his opponents' choices,
 - and so on.
- Suppose that, in addition, type t_i expresses **common belief in rationality**.
 - Take some opponent's choice c_j with $\sigma_j(c_j) > 0$.
 - Then, t_i assigns **positive probability** to c_j .
 - As t_i **believes in j 's rationality**, choice c_j must be **optimal** for player j under the belief σ_{-j} about the opponents' choices.

- Now, take some own choice c_i with $\sigma_i(c_i) > 0$.
- Then, type t_i believes that every opponent j assigns positive probability to c_i .
- As t_i believes that j believes in i 's rationality, choice c_i must be optimal for player i under the belief σ_{-i} about the opponents' choices.
- **Conclusion:** If t_i is a type that
 - has a simple belief hierarchy, generated by the combination of beliefs $(\sigma_1, \dots, \sigma_n)$, and
 - expresses common belief in rationality,
 - then, for every player j , the belief σ_j only assigns positive probability to choices c_j that are optimal under the belief σ_{-j} .

Definition (Nash equilibrium)

The combination of beliefs $(\sigma_1, \dots, \sigma_n)$ is a **Nash equilibrium** if for every player j , the belief σ_j only assigns **positive probability** to choices c_j that are optimal under the belief σ_{-j} .

- Based on **Nash (1950, 1951)**.

Theorem

Consider a **type** t_i which

(1) has a **simple belief hierarchy**, generated by the combination $(\sigma_1, \dots, \sigma_n)$ of beliefs, and

(2) expresses **common belief in rationality**.

Then, the combination of beliefs $(\sigma_1, \dots, \sigma_n)$ must be a **Nash equilibrium**.


- We can show that also the **opposite direction** is true.

Theorem

Consider a **type** t_i with a **simple** belief hierarchy, generated by the combination $(\sigma_1, \dots, \sigma_n)$ of beliefs.

If the combination of beliefs $(\sigma_1, \dots, \sigma_n)$ is a **Nash equilibrium**, then type t_i expresses **common belief in rationality**.

- **Proof.** We first show that t_i **believes in his opponents' rationality**.
- Take an opponent j , and assume that t_i assigns **positive probability** to choice c_j .
- Then $\sigma_j(c_j) > 0$, and hence c_j must be **optimal** for player j under the belief σ_{-j} .
- Since t_i believes that j 's belief about the opponents' choices is σ_{-j} , type t_i believes that c_j is **optimal** for player j .
- So, t_i only assigns **positive probability** to a choice c_j if he believes that c_j is **optimal** for player j .
- Hence, type t_i **believes in his opponents' rationality**.

- **Proof continued.** We next show that t_i believes that his opponents believe in their opponents' rationality.
- Take an opponent j , and some player $k \neq j$. Suppose, t_i believes that player j assigns **positive probability** to choice c_k .
- Then $\sigma_k(c_k) > 0$, and hence c_k must be **optimal** for player k under the belief σ_{-k} .
- Since t_i believes that player j believes that k 's belief about his opponents' choices is σ_{-k} , type t_i believes that player j believes that c_k is **optimal** for player k .
- So, if t_i believes that player j assigns **positive probability** to choice c_k , then t_i believes that player j believes that c_k is **optimal** for player k .
- Hence, type t_i **believes that player j believes in k 's rationality.**
- As such, type t_i **believes that his opponents believe in their opponents' rationality.**
- And so on. 

- By **combining** the two theorems above, we obtain the following **characterization**.

Theorem (Simple belief hierarchies versus Nash equilibrium)

Consider a type t_i with a **simple** belief hierarchy, generated by the combination $(\sigma_1, \dots, \sigma_n)$ of beliefs.

Then, type t_i expresses **common belief in rationality**, if and only if, the combination of beliefs $(\sigma_1, \dots, \sigma_n)$ is a **Nash equilibrium**.

- Other **epistemic foundations** of Nash equilibrium can be found in Spohn (1982), Brandenburger and Dekel (1987, 1989), Tan and Werlang (1988), Aumann and Brandenburger (1995), Polak (1999), Asheim (2006), Perea (2007), Barelli (2009) and Bach and Tsakas (2014).
- All these foundations involve some **correct beliefs** assumption: You believe that your opponents are **correct** about your first-order belief.
- **Not all** layers of **common belief in rationality** are needed to obtain **Nash equilibrium**.

Theorem (Simple belief hierarchies versus Nash equilibrium)

Consider a type t_i with a *simple* belief hierarchy, generated by the combination $(\sigma_1, \dots, \sigma_n)$ of beliefs.

Then, type t_i expresses *common belief in rationality*, if and only if, the combination of beliefs $(\sigma_1, \dots, \sigma_n)$ is a *Nash equilibrium*.

- Important consequence:
- Suppose that in a given game, we wish to find the *simple* belief hierarchies that express *common belief in rationality*.
- Then, it is sufficient to find all the *Nash equilibria* $(\sigma_1, \dots, \sigma_n)$ in the game.

- **Question:** Can we always find **simple** belief hierarchies that express **common belief in rationality**?
- The answer is given by **John Nash**, in his PhD dissertation.

Theorem (Nash equilibrium always exists)

For every game with *finitely many choices* there is at least one **Nash equilibrium** $(\sigma_1, \dots, \sigma_n)$.

Theorem (Common belief in rationality with simple belief hierarchies is always possible)

Consider a game with *finitely many choices*. Then, for every player i there is at least one **simple** belief hierarchy that expresses **common belief in rationality**.

- We wish to find those choices you can rationally make if you
- express **common belief in rationality**, and
- hold a **simple** belief hierarchy.
- Is there a **method** to find these choices?

- Consider a type t_i with a **simple** belief hierarchy, generated by the combination $(\sigma_1, \dots, \sigma_n)$ of beliefs.
- **Remember:** Type t_i expresses **common belief in rationality**, if and only if, the combination $(\sigma_1, \dots, \sigma_n)$ of beliefs is a **Nash equilibrium**.
- Moreover, choice c_i is **optimal** for t_i if c_i is **optimal** under the belief σ_{-i} about the opponents' choices.
- Hence, choice c_i can rationally be made under **common belief in rationality** with a **simple** belief hierarchy, if and only if, there is some **Nash equilibrium** $(\sigma_1, \dots, \sigma_n)$ where c_i is **optimal** under σ_{-i} .

Definition (Nash choice)

A choice c_i is a **Nash choice** if there is some **Nash equilibrium** $(\sigma_1, \dots, \sigma_n)$ where c_i is **optimal** for player i under the belief σ_{-i} .

Definition (Nash choice)

A choice c_i is a **Nash choice** if there is some **Nash equilibrium** $(\sigma_1, \dots, \sigma_n)$ where c_i is **optimal** for player i under the belief σ_{-i} .


- **Observation 1:** If there is a **Nash equilibrium** $(\sigma_1, \dots, \sigma_n)$ with $\sigma_i(c_i) > 0$, then c_i is a **Nash choice**.
- **Proof:** Take some choice c_i with $\sigma_i(c_i) > 0$. Since $(\sigma_1, \dots, \sigma_n)$ is a **Nash equilibrium**, c_i is **optimal** under the belief σ_{-i} .
- Hence, c_i is a **Nash choice**. ■

Definition (Nash choice)

A choice c_i is a **Nash choice** if there is some **Nash equilibrium** $(\sigma_1, \dots, \sigma_n)$ where c_i is **optimal** for player i under the belief σ_{-i} .

- **Observation 2:** A **Nash choice** c_i need not always receive positive probability in a Nash equilibrium.
- **Proof:** Consider the game

	c	d	
a	2, 0	0, 1	.
b	1, 0	1, 0	

- Then, $(b, \frac{1}{2}c + \frac{1}{2}d)$ is a **Nash equilibrium**.
- Since a is **optimal** under the belief $\frac{1}{2}c + \frac{1}{2}d$, choice a is a **Nash choice**.
- However, there is **no Nash equilibrium** (σ_1, σ_2) with $\sigma_1(a) > 0$.
- Indeed, if $\sigma_1(a) > 0$, then only d is optimal for player 2, and hence $\sigma_2 = d$.
- But then, only b can be optimal for player 1, hence $\sigma_1 = b$. This is a **contradiction**. 

Theorem (Simple belief hierarchies versus Nash choices)

Player i can rationally make choice c_i under *common belief in rationality* with a *simple* belief hierarchy, if and only if, c_i is a *Nash choice*.

- **Proof:** (a) Suppose that player i can rationally make choice c_i under *common belief in rationality* with a *simple* belief hierarchy.
- Then, there is an epistemic model and a type t_i in it, such that t_i has a *simple* belief hierarchy generated by $(\sigma_1, \dots, \sigma_n)$, expresses *common belief in rationality*, and c_i is *optimal* for t_i .
- We have seen that $(\sigma_1, \dots, \sigma_n)$ must be a *Nash equilibrium*.
- Since c_i is *optimal* for player i under the belief σ_{-i} , it follows that c_i is a *Nash choice*.

Theorem (Simple belief hierarchies versus Nash choices)

Player i can rationally make choice c_i under *common belief in rationality* with a *simple belief hierarchy*, if and only if, c_i is a *Nash choice*.

- **Proof:** (b) Suppose that c_i is a *Nash choice*.
- Then, there is a *Nash equilibrium* $(\sigma_1, \dots, \sigma_n)$ such that c_i is *optimal* for player i under the belief σ_{-i} .
- Let t_i be the type with the *simple belief hierarchy* generated by $(\sigma_1, \dots, \sigma_n)$.
- We have seen that t_i expresses *common belief in rationality*.
- Hence, c_i is *optimal* for the type t_i that has a *simple belief hierarchy* and expresses *common belief in rationality*. ■

Theorem (Simple belief hierarchies versus Nash choices)

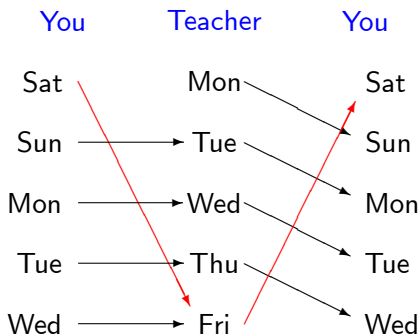
*Player i can rationally make choice c_i under **common belief in rationality** with a **simple belief hierarchy**, if and only if, c_i is a **Nash choice**.*

- Suppose we wish to find those choices that player i can make if
- he holds a **simple belief hierarchy**, and
- he expresses **common belief in rationality**.
- Then, it is sufficient to compute all **Nash choices** for player i in the game.
- **Bad news:** There is no simple algorithm for computing all **Nash equilibria** in a game.
- In some games, this is a **difficult** task.

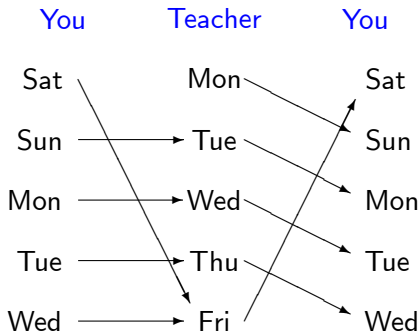
Example: Teaching a lesson

		Teacher				
		Mon	Tue	Wed	Thu	Fri
You	Sat	3, 2	2, 3	1, 4	0, 5	3, 6
	Sun	-1, 6	3, 2	2, 3	1, 4	0, 5
	Mon	0, 5	-1, 6	3, 2	2, 3	1, 4
	Tue	0, 5	0, 5	-1, 6	3, 2	2, 3
	Wed	0, 5	0, 5	0, 5	-1, 6	3, 2

- On what days can you rationally start to study if you hold a **simple belief hierarchy**, and express **common belief in rationality**?



- We have seen:
- You can rationally choose **Saturday** or **Wednesday** under **common belief in rationality** with a **simple** belief hierarchy.
- Namely, the belief hierarchy that supports your choices **Saturday** and **Wednesday** is **simple**, as it is **generated** by the beliefs $\sigma_1 = \text{Sat}$ and $\sigma_2 = \text{Fri}$.



- Are there any **other choices** you can rationally make under **common belief in rationality** with a **simple** belief hierarchy?
- The beliefs diagram does not help here.
- Compute all **Nash equilibria** (σ_1, σ_2) in the game.

	Mon	Tue	Wed	Thu	Fri
Sat	3, 2	2, 3	1, 4	0, 5	3, 6
Sun	-1, 6	3, 2	2, 3	1, 4	0, 5
Mon	0, 5	-1, 6	3, 2	2, 3	1, 4
Tue	0, 5	0, 5	-1, 6	3, 2	2, 3
Wed	0, 5	0, 5	0, 5	-1, 6	3, 2

- Suppose that (σ_1, σ_2) is a Nash equilibrium.
- **Step 1.** Show that $\sigma_2(\text{Thu}) = 0$.
- Suppose that $\sigma_2(\text{Thu}) > 0$. Then, *Thu* must be optimal for the teacher under the belief σ_1 about your choice.
- This is only possible if $\sigma_1(\text{Wed}) > 0$.
- So, *Wed* must be optimal for you under the belief σ_2 .
- This is only possible if $\sigma_2(\text{Fri}) = 1$. **Contradiction.**

	Mon	Tue	Wed	Thu	Fri
Sat	3, 2	2, 3	1, 4	0, 5	3, 6
Sun	-1, 6	3, 2	2, 3	1, 4	0, 5
Mon	0, 5	-1, 6	3, 2	2, 3	1, 4
Tue	0, 5	0, 5	-1, 6	3, 2	2, 3
Wed	0, 5	0, 5	0, 5	-1, 6	3, 2

- **Step 2.** Show that $\sigma_2(\text{Wed}) = 0$.
- Suppose that $\sigma_2(\text{Wed}) > 0$. Then, **Wed** must be optimal for the teacher under the belief σ_1 .
- This is only possible if $\sigma_1(\text{Tue}) > 0$.
- Then, **Tue** must be optimal for you under the belief σ_2 .
- This is only possible if $\sigma_2(\text{Thu}) > 0$. **Contradiction.**

	Mon	Tue	Wed	Thu	Fri
Sat	3, 2	2, 3	1, 4	0, 5	3, 6
Sun	-1, 6	3, 2	2, 3	1, 4	0, 5
Mon	0, 5	-1, 6	3, 2	2, 3	1, 4
Tue	0, 5	0, 5	-1, 6	3, 2	2, 3
Wed	0, 5	0, 5	0, 5	-1, 6	3, 2

- **Step 3.** Show that $\sigma_2(\text{Tue}) = 0$.
- Suppose that $\sigma_2(\text{Tue}) > 0$. Then, **Tue** must be optimal for the teacher under the belief σ_1 .
- This is only possible if $\sigma_1(\text{Mon}) > 0$. Otherwise, **Tue** would be **strictly dominated** for the teacher by $(0.9) \cdot \text{Wed} + (0.1) \cdot \text{Thu}$.
- So, **Mon** must be optimal for you under the belief σ_2 .
- This is only possible if $\sigma_2(\text{Wed}) > 0$ or $\sigma_2(\text{Thu}) > 0$. **Contradiction.**

	Mon	Tue	Wed	Thu	Fri
Sat	3, 2	2, 3	1, 4	0, 5	3, 6
Sun	-1, 6	3, 2	2, 3	1, 4	0, 5
Mon	0, 5	-1, 6	3, 2	2, 3	1, 4
Tue	0, 5	0, 5	-1, 6	3, 2	2, 3
Wed	0, 5	0, 5	0, 5	-1, 6	3, 2

- **Step 4.** Show that $\sigma_2(\text{Mon}) = 0$.
- Suppose that $\sigma_2(\text{Mon}) > 0$. Then, *Mon* must be optimal for the teacher under the belief σ_1 .
- This is only possible if $\sigma_1(\text{Sun}) > 0$. Otherwise, *Mon* would be **strictly dominated** for the teacher by $(0.9) \cdot \text{Tue} + (0.09) \cdot \text{Wed} + (0.01) \cdot \text{Thu}$.
- So, *Sun* must be optimal for you under the belief σ_2 .
- This is only possible if $\sigma_2(\text{Tue}) > 0$. **Contradiction.**

	Mon	Tue	Wed	Thu	Fri
Sat	3, 2	2, 3	1, 4	0, 5	3, 6
Sun	-1, 6	3, 2	2, 3	1, 4	0, 5
Mon	0, 5	-1, 6	3, 2	2, 3	1, 4
Tue	0, 5	0, 5	-1, 6	3, 2	2, 3
Wed	0, 5	0, 5	0, 5	-1, 6	3, 2

- So, if (σ_1, σ_2) is a Nash equilibrium, then σ_2 must assign probability 0 to Mon, Tue, Wed and Thu. Hence, $\sigma_2 = \text{Fri}$.
- But then, your optimal choices under the belief σ_2 are Sat and Wed.
- Hence, your only Nash choices in this game are Sat and Wed.
- These are the only choices you can rationally make under common belief in rationality with a simple belief hierarchy.

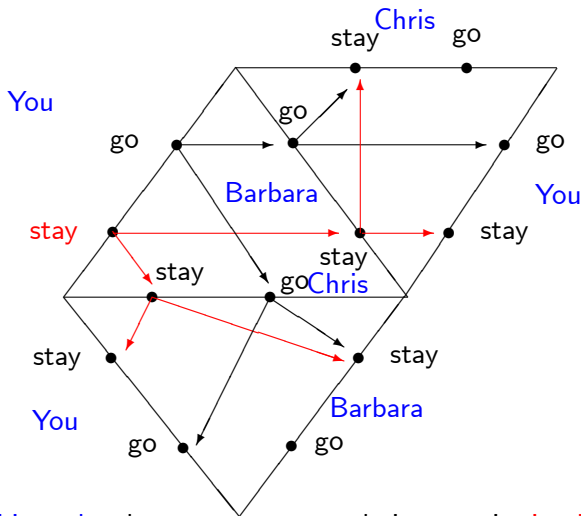
	Mon	Tue	Wed	Thu	Fri
Sat	3, 2	2, 3	1, 4	0, 5	3, 6
Sun	-1, 6	3, 2	2, 3	1, 4	0, 5
Mon	0, 5	-1, 6	3, 2	2, 3	1, 4
Tue	0, 5	0, 5	-1, 6	3, 2	2, 3
Wed	0, 5	0, 5	0, 5	-1, 6	3, 2

Summarizing

- Under **common belief in rationality**, you can rationally start to study on **any day** between **Saturday** and **Wednesday**.
- However, if you hold a **simple** belief hierarchy in addition, then under common belief in rationality you can only rationally start to study on **Saturday** or **Wednesday**.
- **Crucial difference**: With a **simple** belief hierarchy, you believe that the teacher is **correct** about your beliefs.

Example: Movie or party?

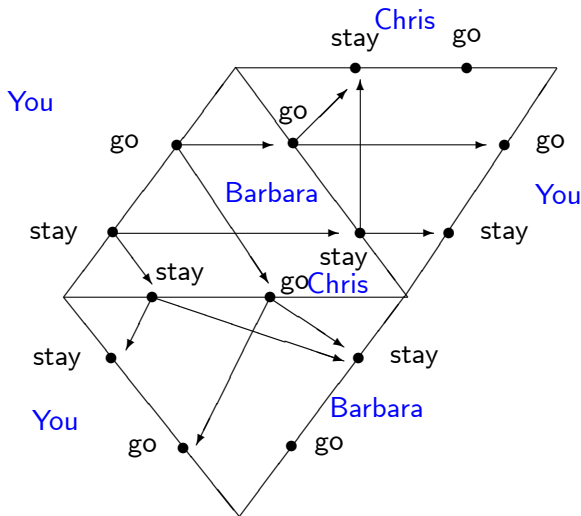
- Having a **good time** at the party gives you utility **3**, watching the **movie** gives you utility **2**, whereas having a **bad time** at the party gives you utility **0**. Similarly for Barbara and Chris.
- You will only have a **good time** at the party if **Barbara and Chris** both join.
- Barbara will only have a **good time** at the party if **you** join, but **not Chris**.
- Chris will only have a **good time** at the party if **you** join, but **not Barbara**.
- What choice(s) can you rationally make if you hold a **simple** belief hierarchy, and express **common belief in rationality**?



- The belief hierarchy that supports your choice stay is simple: It is completely generated by the beliefs

$\sigma_1 = \text{You stay}$, $\sigma_2 = \text{Barbara stays}$, $\sigma_3 = \text{Chris stays}$.

- So, you can rationally stay at home under common belief in rationality with a simple belief hierarchy.



- In this beliefs diagram, your choice to go the party is **not** supported by a **simple** belief hierarchy.
- But **can** your choice go be supported by a **simple** belief hierarchy that expresses **common belief in rationality**?

- Let us try to find **all Nash equilibria** in this game, and see whether your choice **go** is a **Nash choice**.

You stay	C stays	C goes	You go	C stays	C goes
B stays	2, 2, 2	2, 2, 0	B stays	0, 2, 2	0, 2, 3
B goes	2, 0, 2	2, 0, 0	B goes	0, 3, 2	3, 0, 0

- Suppose that $(\sigma_1, \sigma_2, \sigma_3)$ is a **Nash equilibrium** in this game.
- We first show that $\sigma_1(\text{go}) = 0$.
- Assume that $\sigma_1(\text{go}) > 0$. Then, **go** must be optimal for you under the belief (σ_2, σ_3) .
- For you, $u_1(\text{go}) = 3 \cdot \sigma_2(\text{go}) \cdot \sigma_3(\text{go})$, whereas $u_1(\text{stay}) = 2$.
- Hence, $\sigma_2(\text{go}) \cdot \sigma_3(\text{go}) \geq 2/3$, which implies $\sigma_2(\text{go}) \geq 2/3$ and $\sigma_3(\text{go}) \geq 2/3$. This implies $\sigma_3(\text{stay}) \leq 1/3$.
- So, **go** must be optimal for Barbara under the belief (σ_1, σ_3) .
- But for Barbara,

$$u_2(\text{go}) = 3 \cdot \sigma_1(\text{go}) \cdot \sigma_3(\text{stay}) \leq 1 < u_2(\text{stay}),$$

which means that **go** is not optimal for Barbara. **Contradiction.**

You stay	C stays	C goes
B stays	2, 2, 2	2, 2, 0
B goes	2, 0, 2	2, 0, 0

You go	C stays	C goes
B stays	0, 2, 2	0, 2, 3
B goes	0, 3, 2	3, 0, 0

- So we conclude that $\sigma_1(\text{stay}) = 1$.
- But then, for Barbara only **stay** can be optimal under the belief (σ_1, σ_3) . Hence, $\sigma_2 = \text{stay}$.
- Similarly, for Chris only **stay** can be optimal under the belief (σ_1, σ_2) . Consequently, $\sigma_3 = \text{stay}$.
- So, the **only Nash equilibrium** is

$$\sigma_1 = \text{stay}, \sigma_2 = \text{stay}, \sigma_3 = \text{stay}.$$

- Under the belief (σ_2, σ_3) , your only optimal choice is to **stay** at home. Hence, your **only Nash choice** is to **stay** at home.

You stay	C stays	C goes	You go	C stays	C goes
B stays	2, 2, 2	2, 2, 0	B stays	0, 2, 2	0, 2, 3
B goes	2, 0, 2	2, 0, 0	B goes	0, 3, 2	3, 0, 0

Summarizing

- Under **common belief in rationality** you can either **stay** at home, or **go** to the party.
- However, if you hold a **simple** belief hierarchy, then under **common belief in rationality** your only rational choice is to **stay** at home.
- **Crucial difference:** With a **simple** belief hierarchy, you believe that Barbara has the **same** belief about Chris' choice as you do.

Other classes of games

- **Simple belief hierarchies**, and **variants of Nash equilibrium**, have also been defined for other classes of games:
- **generalized Nash equilibrium** in **games with incomplete information**: Bach and Perea (2017)
- **psychological Nash equilibrium** in **psychological games**: Geanakoplos, Pearce and Stacchetti (1989)
- **Research question**: Other epistemic foundations for **Nash equilibrium**?
- **Research question**: Applications of **generalized Nash equilibrium** to models in economics?

- **Common prior** is a condition on belief hierarchies that is **weaker** than simple belief hierarchies.
- **Common belief in rationality** together with a **common prior** leads to **correlated equilibrium**: **Aumann (1974, 1987)**. See **Bach and Perea (2017)** for a proof.
- Some years earlier, **Harsanyi (1967–1968)** defined **Bayesian equilibrium** in games with **incomplete information**, which is also based on common belief in rationality with a common prior (**Bach and Perea (2017)**).
- **Correlated equilibrium** is **Bayesian equilibrium** when applied to games with **complete information**.
- **Research question**: Other conditions on belief hierarchies, besides simple belief hierarchies and common prior?
- **Research question**: Epistemic foundation for common prior?

Conditions leading to simple belief hierarchies

- We have concentrated on **simple** belief hierarchies.
- But which **epistemic conditions** lead to a **simple** belief hierarchy?
- We focus on the case of **two players** only.

- In a two-player game, a simple belief hierarchy for player i is completely generated by a pair of beliefs (σ_i, σ_j) . That is:
 - player i holds belief σ_j about j 's choice,
 - player i believes that player j holds belief σ_i about i 's choice,
 - player i believes that player j believes that, indeed, player i holds belief σ_j about j 's choice,
 - player i believes that player j believes that player i believes that, indeed, player j holds belief σ_i about i 's choice,
 - and so on.
- So, if player i holds a simple belief hierarchy, then he believes that his opponent is correct about his belief hierarchy. We say that player i believes that player j holds correct beliefs.
- Moreover, if player i holds a simple belief hierarchy, he also believes that player j believes that i has correct beliefs.

Definition (Belief that opponents hold correct beliefs)

A type t_i believes that his opponent holds **correct beliefs** if he believes that his opponent believes that, indeed, his type is t_i .

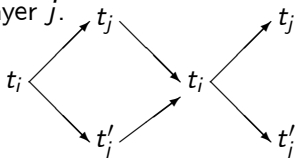
- Based on [Perea \(2007\)](#).
- We have seen that in a **two-player** game, a type with a **simple** belief hierarchy believes that his opponent holds **correct beliefs**, and believes that his opponent believes that he himself holds **correct beliefs** too.
- In fact, the **other direction** is also true: If in a **two-player** game a type believes that his opponent holds **correct beliefs**, and believes that his opponent believes that he himself holds **correct beliefs** too, then this type has a **simple** belief hierarchy.

Theorem (Characterization of types with a simple belief hierarchy in two-player games)

Consider a game with two players.

A type t_i for player i has a **simple belief hierarchy**, if and only if, t_i believes that his opponent holds **correct beliefs**, and believes that his opponent believes that he himself holds **correct beliefs** too.

- **Proof.** Based on [Perea \(2007\)](#). Suppose that type t_i believes that his opponent holds **correct beliefs**, and believes that his opponent believes that he himself holds **correct beliefs** too.
- **Show:** Type t_i assigns **probability 1** to a **single** type t_j for player j .
- Suppose that t_i would assign **positive probability** to **two different** types t_j and t'_j for player j .



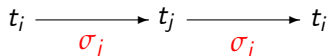
- Then, t_j would **not** believe that i holds **correct beliefs**. **Contradiction.**

Theorem (Characterization of types with a simple belief hierarchy in two-player games)

Consider a game with two players.

*A type t_i for player i has a **simple** belief hierarchy, if and only if, t_i believes that his opponent holds **correct beliefs**, and believes that his opponent believes that he himself holds **correct beliefs** too.*

- So, we know that t_i assigns **probability 1** to some type t_j for player j , and t_j assigns **probability 1** to t_i .
- Let σ_j be the belief that t_i has about j 's choice, and let σ_i be the belief that t_j has about i 's choice.















- But then, t_i 's belief hierarchy is **generated** by (σ_i, σ_j) . So, t_i has a **simple** belief hierarchy. ■






- **Be careful:** If we have **more than two players**, then these conditions are **no longer enough** to induce **simple** belief hierarchies.
- In a game with **more than two players**, we need to impose the following **extra** conditions:
- you believe that player j has the **same belief** about player k as you do;
- your belief about player j 's choice must be **independent** from your belief about player k 's choice.

How reasonable is Nash equilibrium?

- We have seen that a **Nash equilibrium** makes the following assumptions:
- you believe that your opponents are **correct** about the beliefs that you hold;
- you believe that player j holds the **same belief** about player k as you do;
- your belief about player j 's choice is **independent** from your belief about player k 's choice.
- Each of these conditions is actually very **questionable**.
- Therefore, **Nash equilibrium** is perhaps **not** such a **natural** concept after all.

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