

# Epistemic Effects

- ▶ What is your favorite (e.g., color or political candidate)
- ▶ What do you think is everyone's favorite
  - ▶ Involves social intelligence

# Beauty Contest Prelude

Term due to Keynes to disparage stock market valuations

- ▶ Think of an integer in  $[0, 100]$
- ▶ Win if you are closest to the median (for simplicity)

# Beauty Contest

- ▶ Think of an integer in  $[0, 100]$
- ▶ Win if you are closest to 70% of the median

# Equilibrium

Exercise: What's the mathematically optimal answer?

# Behavioral Economics

Rosemarie Nagel, Colin Camerer

- ▶ How people behave has little to do with optimality
  - ▶ Not “rational”
  - ▶ Not equilibrium
- ▶ Cognitive hierarchy (aka Level  $k$  model)
  - ▶ Thinkers at level  $i + 1$  model others as thinkers of level  $i$
  - ▶ Few humans go above level 3
  - ▶ For humans on average,  $k \approx 1.5$

# Focal Points: 1

Thomas Schelling

- ▶ Coordination of decisions without explicit communication
  - ▶ Schelling considered the nuclear arms race: How come nobody started a nuclear war
- ▶ Select an integer from  $[0, 100]$
- ▶ Win by being closest to the mode

## Focal Points: 2

- ▶ How do you meet a friend in an international airport?
  - ▶ Imagine no working phones
  - ▶ No public announcements