

CPS 296.1

Mechanism design

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Mechanism design: setting

- The **center** has a set of outcomes O that she can choose from
 - Allocations of tasks/resources, joint plans, ...
- Each agent i draws a **type** θ_i from Θ_i
 - usually, but not necessarily, according to some probability distribution
- Each agent has a (commonly known) **valuation function** $v_i: \Theta_i \times O \rightarrow \mathcal{R}$
 - Note: depends on θ_i , which is **not** commonly known
- The center has some **objective function** $g: \Theta \times O \rightarrow \mathcal{R}$
 - $\Theta = \Theta_1 \times \dots \times \Theta_n$
 - E.g., efficiency ($\sum_i v_i(\theta_i, o)$)
 - May also depend on payments (more on those later)
 - The center does **not** know the types

What should the center do?

- She would like to know the agents' types to make the best decision
- Why not just ask them for their types?
- Problem: agents might **lie**
- E.g., an agent that slightly prefers outcome 1 may say that outcome 1 will give him a value of 1,000,000 and everything else will give him a value of 0, to force the decision in his favor
- But maybe, if the center is clever about choosing outcomes and/or requires the agents to make some **payments** depending on the types they report, the incentive to lie disappears...

Quasilinear utility functions

- For the purposes of mechanism design, we will assume that an agent's utility for
 - his type being θ_i ,
 - outcome o being chosen,
 - and having to pay π_i ,can be written as $v_i(\theta_i, o) - \pi_i$
- Such utility functions are called **quasilinear**
- Some of the results that we will see can be generalized beyond such utility functions, but we will not do so

Definition of a (direct-revelation) mechanism

- A **deterministic mechanism without payments** is a mapping $o: \Theta \rightarrow O$
- A **randomized mechanism without payments** is a mapping $o: \Theta \rightarrow \Delta(O)$
 - $\Delta(O)$ is the set of all probability distributions over O
- Mechanisms **with payments** additionally specify, for each agent i , a payment function $\pi_i: \Theta \rightarrow \mathcal{R}$ (specifying the payment that that agent must make)
- Each mechanism specifies a **Bayesian game** for the agents, where i 's set of actions $A_i = \Theta_i$
 - We would like agents to use the truth-telling strategy defined by $s(\theta_i) = \theta_i$

Incentive compatibility

- **Incentive compatibility** (aka. **truthfulness**) = there is never an incentive to lie about one's type
- A mechanism is **dominant-strategies** incentive compatible (aka. **strategy-proof**) if for any i , for any type vector $\theta_1, \theta_2, \dots, \theta_i, \dots, \theta_n$, and for any alternative type θ_i' , we have

$$v_i(\theta_i, o(\theta_1, \theta_2, \dots, \theta_i, \dots, \theta_n)) - \pi_i(\theta_1, \theta_2, \dots, \theta_i, \dots, \theta_n) \geq v_i(\theta_i, o(\theta_1, \theta_2, \dots, \theta_i', \dots, \theta_n)) - \pi_i(\theta_1, \theta_2, \dots, \theta_i', \dots, \theta_n)$$

- A mechanism is **Bayes-Nash equilibrium (BNE)** incentive compatible if telling the truth is a BNE, that is, for any i , for any types θ_i, θ_i' ,

$$\sum_{\theta_{-i}} P(\theta_{-i}) [v_i(\theta_i, o(\theta_1, \theta_2, \dots, \theta_i, \dots, \theta_n)) - \pi_i(\theta_1, \theta_2, \dots, \theta_i, \dots, \theta_n)] \geq$$

$$\sum_{\theta_{-i}} P(\theta_{-i}) [v_i(\theta_i, o(\theta_1, \theta_2, \dots, \theta_i', \dots, \theta_n)) - \pi_i(\theta_1, \theta_2, \dots, \theta_i', \dots, \theta_n)]$$

Individual rationality

- A selfish center: “All agents must give me all their money.” – but the agents would simply not participate
 - If an agent would not participate, we say that the mechanism is not **individually rational**
- A mechanism is **ex-post** individually rational if for any i , for any type vector $\theta_1, \theta_2, \dots, \theta_i, \dots, \theta_n$, we have
$$v_i(\theta_i, o(\theta_1, \theta_2, \dots, \theta_i, \dots, \theta_n)) - \pi_i(\theta_1, \theta_2, \dots, \theta_i, \dots, \theta_n) \geq 0$$
- A mechanism is **ex-interim** individually rational if for any i , for any type θ_i ,
$$\sum_{\theta_{-i}} P(\theta_{-i}) [v_i(\theta_i, o(\theta_1, \theta_2, \dots, \theta_i, \dots, \theta_n)) - \pi_i(\theta_1, \theta_2, \dots, \theta_i, \dots, \theta_n)] \geq 0$$
 - i.e., an agent will want to participate given that he is uncertain about others' types (not used as often)

The **Clarke** (aka. **VCG**) mechanism [Clarke 71]

- The Clarke mechanism chooses some outcome o that maximizes $\sum_i v_i(\theta_i', o)$
 - θ_i' = the type that i reports
- To determine the payment that agent j must make:
 - Pretend j does not exist, and choose o_{-j} that maximizes $\sum_{i \neq j} v_i(\theta_i', o_{-j})$
 - j pays $\sum_{i \neq j} v_i(\theta_i', o_{-j}) - \sum_{i \neq j} v_i(\theta_i', o) = \sum_{i \neq j} (v_i(\theta_i', o_{-j}) - v_i(\theta_i', o))$
- We say that each agent pays the **externality** that she imposes on the other agents
- (VCG = Vickrey, Clarke, Groves)

The Clarke mechanism is strategy-proof

- Total utility for agent j is
$$v_j(\theta_j, o) - \sum_{i \neq j} (v_i(\theta_i', o_{-j}) - v_i(\theta_i', o)) =$$
$$v_j(\theta_j, o) + \sum_{i \neq j} v_i(\theta_i', o) - \sum_{i \neq j} v_i(\theta_i', o_{-j})$$
- But agent j cannot affect the choice of o_{-j}
- Hence, j can focus on maximizing $v_j(\theta_j, o) + \sum_{i \neq j} v_i(\theta_i', o)$
- But mechanism chooses o to maximize $\sum_i v_i(\theta_i', o)$
- Hence, if $\theta_j' = \theta_j$, j 's utility will be maximized!
- Extension of idea: add **any** term to agent j 's payment that does not depend on j 's reported type
- This is the family of **Groves** mechanisms [Groves 73]

Generalized Vickrey Auction (GVA)

(= VCG applied to combinatorial auctions)

- Example:
 - Bidder 1 bids ($\{A, B\}$, 5)
 - Bidder 2 bids ($\{B, C\}$, 7)
 - Bidder 3 bids ($\{C\}$, 3)
- Bidders 1 and 3 win, total value is 8
- Without bidder 1, bidder 2 would have won
 - Bidder 1 pays $7 - 3 = 4$
- Without bidder 3, bidder 2 would have won
 - Bidder 3 pays $7 - 5 = 2$
- Strategy-proof, ex-post IR, weakly budget balanced
- Vulnerable to **collusion** (more so than 1-item Vickrey auction)
 - E.g., add two bidders ($\{B\}$, 100), ($\{A, C\}$, 100)
 - What happens?
 - More on collusion in GVA in [Ausubel & Milgrom 06, Conitzer & Sandholm 06]

Additional nice properties of the Clarke mechanism

- Ex-post individually rational, assuming:
 - An agent's presence never makes it impossible to choose an outcome that could have been chosen if the agent had not been present, and
 - No agent ever has a negative value for an outcome that would be selected if that agent were not present
- **Weak budget balanced** - that is, the sum of the payments is always nonnegative - assuming:
 - If an agent leaves, this never makes the combined welfare of the other agents (not considering payments) smaller

Clarke mechanism is not perfect

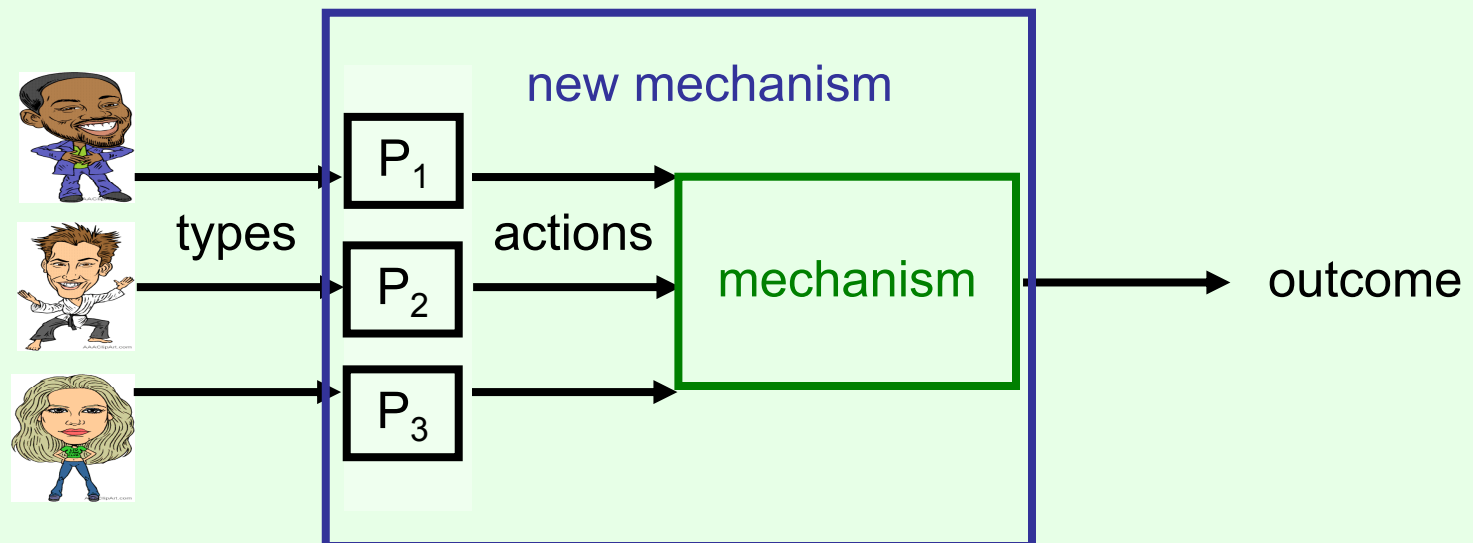
- Requires payments + quasilinear utility functions
- In general money needs to flow away from the system
 - Strong budget balance = payments sum to 0
 - In general, this is impossible to obtain in addition to the other nice properties [Green & Laffont 77]
- Vulnerable to collusion
 - E.g., suppose two agents both declare a ridiculously large value (say, \$1,000,000) for some outcome, and 0 for everything else. What will happen?
- Maximizes sum of agents' utilities (if we do not count payments), but sometimes the center is not interested in this
 - E.g., sometimes the center wants to maximize revenue

Why restrict attention to truthful direct-revelation mechanisms?

- Bob has an incredibly complicated mechanism in which agents do not report types, but do all sorts of other strange things
- E.g.: Bob: “In my mechanism, first agents 1 and 2 play a round of rock-paper-scissors. If agent 1 wins, she gets to choose the outcome. Otherwise, agents 2, 3 and 4 vote over the other outcomes using the Borda rule. If there is a tie, everyone pays \$100, and...”
- Bob: “The **equilibria** of my mechanism produce better results than any truthful direct revelation mechanism.”
- Could Bob be right?

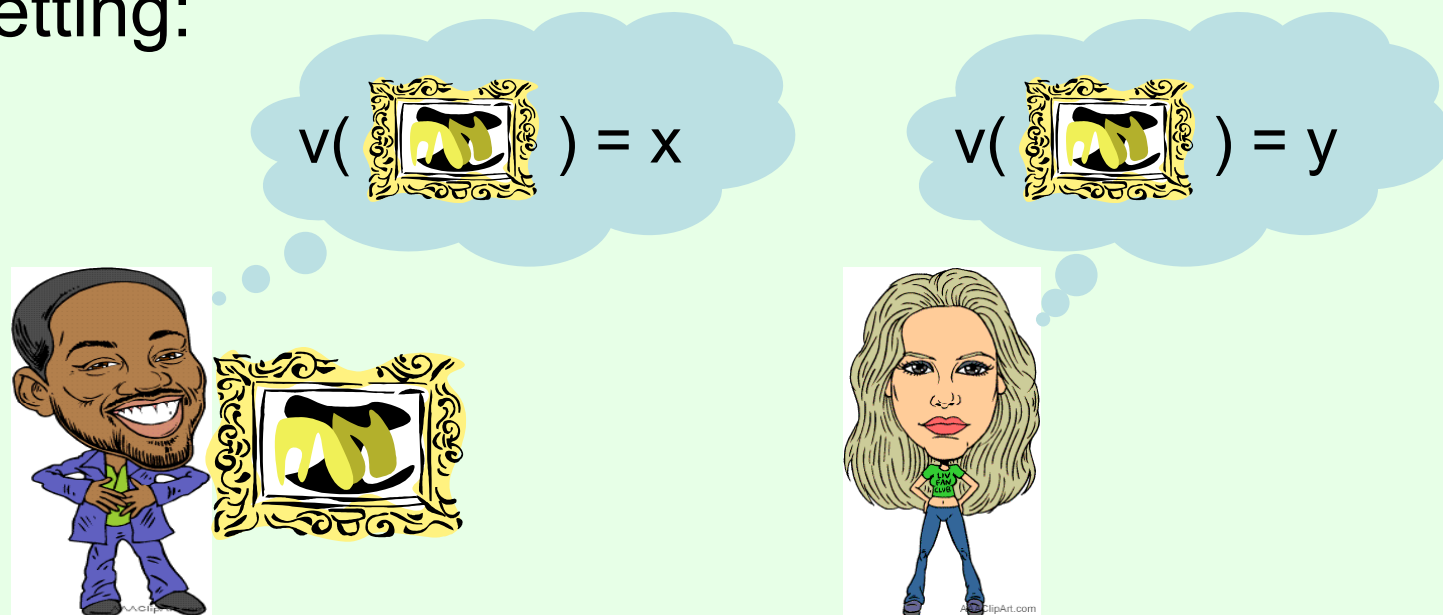
The revelation principle

- For any (complex, strange) mechanism that produces certain outcomes under strategic behavior (dominant strategies, BNE)...
- ... there exists a (dominant-strategies, BNE) incentive compatible direct revelation mechanism that produces the same outcomes!



Myerson-Satterthwaite impossibility [1983]

- Simple setting:



- We would like a mechanism that:
 - is efficient (trade if and only if $y > x$),
 - is budget-balanced (seller receives what buyer pays),
 - is BNE incentive compatible, and
 - is ex-interim individually rational
- This is impossible!

A few computational issues in mechanism design

- **Algorithmic** mechanism design
 - Sometimes standard mechanisms are too hard to execute computationally (e.g., Clarke requires computing optimal outcome)
 - Try to find mechanisms that are easy to execute computationally (and nice in other ways), together with algorithms for executing them
- **Automated** mechanism design
 - Given the specific setting (agents, outcomes, types, priors over types, ...) and the objective, have a **computer** solve for the best mechanism for this particular setting
- When agents have **computational limitations**, they will not necessarily play in a game-theoretically optimal way
 - Revelation principle can collapse; need to look at nontruthful mechanisms
- Many other things (computing the outcomes in a **distributed** manner; what if the agents come in over time (**online** setting); ...)