

# Bidding Strategies for Simultaneous Ascending Auctions

Michael P. Wellman, Anna Osepayshvili, Jeffrey K. MacKie-Mason  
University of Michigan  
Ann Arbor, MI 48109 USA  
{wellman, annaose, jmm}@umich.edu

Daniel M. Reeves  
Yahoo! Research  
45 W 18th St, 6th Floor  
New York, NY 10011 USA  
dreeves@yahoo-inc.com

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## Abstract

Simultaneous ascending auctions present agents with various strategic problems, depending on preference structure. As long as bids represent non-repudiable offers, submitting non-contingent bids to separate auctions entails an *exposure problem*: bidding to acquire a bundle risks the possibility of obtaining an undesired subset of the goods. With multiple goods (or units of a homogeneous good) bidders also need to account for their own effects on prices. Auction theory does not provide analytic solutions for optimal bidding strategies in the face of these problems. We present a new family of decision-theoretic bidding strategies that use probabilistic predictions of final prices: *self-confirming distribution-prediction* strategies. Bidding based on these is provably not optimal in general. But evidence using empirical game-theoretic methods we developed indicates the strategy is quite effective compared to other known methods when preferences exhibit complementarities. When preferences exhibit substitutability, simpler *demand-*

*reduction* strategies address the own price effect problem more directly and perform better.

## 1 Introduction

A *simultaneous ascending auction* (SAA) [Cramton, 2005] allocates a set of  $m$  related goods among  $n$  agents via separate, concurrent English auctions for each good. This is characteristic of a variety of related but not identical real-world auction mechanisms, such as concurrent independent auctions on eBay, power markets, spectrum auctions in many countries, and other explicitly designed trading environments [Milgrom, 2003]. Some of the key strategic issues presented by SAAs apply whenever there are concurrent markets for interrelated goods, even if those markets are not formal auctions.

Simultaneity is significant only if demands (or supplies) for the various goods are interrelated. We address here some of the challenges bidders with such demands face when formulating their strategies for participation in SAAs. Inter-related demands generally exhibit *complementarity* or *substitutability* (or both), each of which induces characteristic bidding problems.

To study bidding strategies in the face of the strategic challenges presented by complementarity or substitutability, we intentionally abstract from any single application. There are features specific to spectrum auctions, for example, that we do not address, just as there are unaddressed features specific to simultaneous eBay auctions and other particular SAA environments. In hope of producing results generalizable to a range of applications, we analyze a generic SAA exhibiting a few important characteristics that are common across most specific settings.

Complementarity manifests when an agent's value for a good is greater if it also obtains one or more other goods [Lehmann et al., 2006]. For example, an airline passenger may wish to obtain two connecting segments to complete a trip. Goods exhibit complementarity from the perspective of an agent when her valuation for those goods is *superadditive*. Let  $X$ ,  $Y$ , and  $Z$  be sets of goods such that  $Y \cup Z = X$  and  $Y \cap Z = \emptyset$ . Given a quasi-linear valuation function,  $v: 2^{|X|} \rightarrow \mathbb{R}$ , that assigns value to possible subsets of  $X$ , superadditive preference for  $Y$  and  $Z$  means that  $v(X) > v(Y) + v(Z)$ . In other words, the combined bundle  $X$  is worth more than the sum of its parts. As a special case, if goods in a set are each worthless without the others, they are *perfect complements*. We say that a valuation exhibits complementarities if there are some subsets of goods for which preference is superadditive.

When the inequality is reversed, the valuation is *subadditive*, which occurs for example when goods are substitutes. Flights on the same route by different airlines would typically be considered substitutes, as would flights to two candidate vacation destinations. Technically, goods are substitutes when raising the price of one does not decrease demand for others—that is, for any optimal bundle before the price increase there is an optimal bundle post-increase that includes at least as much demand for all goods that did not increase in price. Substitutability is a strictly stronger condition than subadditivity [Lehmann et al., 2006]. An important extreme case of substitutability is perfect substitutes or *single-unit demand* [Gul and Stacchetti, 1999], where for all  $Y \subseteq X$ ,  $v(Y) = \max_{i \in Y} v(\{i\})$ . If, in addition, goods are (for this agent) *homogeneous* then they are 1:1 perfect substitutes.

Concurrent auctions with interdependent goods are strategically challenging because agents bid separately in auctions for each item, but willingness-to-pay depends nontrivially on which combination of items the agent ultimately wins. When bids represent non-repudiable offers, submitting bids to separate auctions entails an *exposure problem*. With complementarities, if an agent bids on a set of items based on her willingness-to-pay for the set, she may pay more than her valuation for the subset she actually wins. With substitutes, an agent bidding based on willingness-to-pay for individual goods risks paying more for a set than it is worth. The SAA mechanism makes it easy for agents to avoid exposure in the case of substitutes. Since a price increase for one good cannot decrease demand for others, the agents can manage their bids to ensure they are never winning more goods than they want at the current prices. With any violation of substitutability, however, a bidder cannot in general obtain a desired package without incurring some exposure risk.

The exposure problem motivates mechanisms that take complementarities directly into account, such as *combinatorial auctions* [Cramton et al., 2005, de Vries and Vohra, 2003], in which the auction mechanism determines optimal packages based on agent bids over bundles. Although such mechanisms may provide an effective solution in many cases, there are often significant barriers to their application [MacKie-Mason and Wellman, 2005]. Indeed, SAA-based auctions are often deliberately adopted, despite awareness of strategic complications [Milgrom, 2003, McAfee and McMillan, 1996].

A second strategic problem for bidders is accounting for *own price effects*: the impact of their own bids on resulting prices. For example, a bidder winning  $q$  units may find that bidding her incremental value for the  $q + 1$ st unit results in an increase in price paid for the first  $q$  units. The strategy of shading bids to take

account of this inframarginal surplus loss is known as *demand reduction* [Ausubel and Cramton, 2002, Weber, 1997].

Given exposure and own price effects, it is clear that bidding willingness-to-pay is generally not optimal. Worse for designers, researchers, and bidders, auction theory to date [Krishna, 2002] has little to say about how one should bid in simultaneous markets with substitutes or complements. There exists no useful analytical characterization of equilibria for SAA games. Moreover, the best-response strategies to even simple specified bidding policies can be surprisingly complex [Reeves et al., 2005]. Simulation studies shed light on some strategic issues [Csirik et al., 2001], as have accounts of strategies employed in specific auctions [Cramton, 1995, Weber, 1997], but the game is too complex to admit definitive strategic recommendations. We cannot emphasize this point enough: there is a striking gap in the literature, and the main motivation for the novel empirical methods we employ is that analytically deriving equilibrium strategies appears intractable for nontrivial SAA games.

We employ a different approach to analyze bidding strategies, which we elsewhere describe as a *computational reasoning* [MacKie-Mason and Wellman, 2005] or *empirical game-theoretic* methodology [Wellman, 2006] for analyzing mechanisms and strategies. We begin with an explicit formulation of the resource allocation problem, generate a set of candidate parametrized strategies, then simulate the game for various profiles of strategy parameters. Through simulation, we in effect convert an extensive-form game of incomplete information with high-dimensional strategy space into a normal-form game over the restricted set of strategies defined by the instances of strategy parameters explored. We then use standard tools to solve the restricted-strategy (yet often still quite large) normal-form games, and analyze the results. For the families of candidate strategies we study, we are able to characterize those which participate in equilibria of the transformed game, and the quality of the resulting outcomes.

One advantage of this fundamentally empirical method is that if others believe they have superior strategies, it is straightforward to apply the method *incrementally* to evaluate the new candidates with respect to the best-performing strategies known to date. This is important because the SAA environment is so complex, and in any SAA the specific rules may call for variations on the basic strategy family we study. For example, some auctions impose activity rules, which introduces an eligibility management problem into the design of bidding strategies. Budget constraints may also affect the design of bidding strategies. We do not claim that our present analysis covers the entire space of bidding-strategy design for SAAs. We do claim that we provide some of the first systematic evidence

for a successful family of strategies in a generic SAA. We also claim that strategic lessons from this generic environment will be a useful starting point for those designing strategies for the rules of particular SAA environments they face.

We next proceed with a formal specification of the problem and of the generic SAA mechanism we study.

## 2 The Simultaneous Ascending Auctions (SAA) Domain

The formal specification of the *SAA game* includes a number of agents,  $n$ , a number of goods,  $m$ , a type distribution that yields valuation functions  $v_j$  for the agents  $j \in \{1, \dots, n\}$ ,<sup>1</sup> and a specification of the SAA mechanism rules. In general the SAA mechanism comprises  $m$  separate auctions, one for each good, that operate over multiple rounds of bidding. In the generic SAA version we study, bidding is synchronized so that in each round each agent submits a bid in every auction in which it chooses to bid. At any given time, the *bid price* on good  $i$  is  $\beta_i$ , defined to be the highest bid  $b_i$  received thus far, or zero if there have been no bids. The bid price along with the current winner in every auction is announced at the beginning of each new round. To be admissible, a new bid must meet the *ask price*, i.e., the bid price plus a bid increment (which we take to be one w.l.o.g., allowing for scaling of the agent values):  $b_i^{new} \geq \beta_i + 1$ . If an auction receives multiple admissible bids in a given round, it admits the highest, breaking ties randomly. An auction is *quiescent* when a round passes with no new admissible bids, i.e., the new bid prices  $\beta^{new} = \beta$  which become the final prices  $p$ . When every auction is simultaneously quiescent they all close, allocating their respective goods per the last admitted bids.

An agent's *current information state*,  $\mathbf{B}$ , comprises the current bid prices,  $\beta$ , along with a bit vector indicating which goods the agent is currently winning. Let  $\mathcal{B}$  denote the set of possible current information states. A *local bidding strategy* is a mapping  $\mathcal{B} \rightarrow \mathbf{b}$ , where the bid vector  $\mathbf{b}$  specifies a bid for each of the  $m$  auctions. More generally, an agent's bidding strategy maps the *history* of information states to bids. For the present work, we limit consideration to local bidding strategies. This is a substantive limitation, ruling out, for example, methods that infer other agents' types from dynamic price patterns, or strategies that punish others'

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<sup>1</sup>We may include in the type distribution *Nature's type* which determines the random tie-breaking when agents place identical bids.

behavior. Nevertheless, the strategic issues we consider primary can be addressed at the level of local bidding strategies, and thus we take the simplification achieved through ignoring history to be worthwhile.<sup>2</sup>

Submitting an inadmissible bid (e.g.,  $b_i = 0$ ) is equivalent to not bidding. An agent’s payoff—also referred to as its *surplus*—is defined by the auction outcomes, namely, the set of goods it wins,  $X$ , and the final prices,  $\mathbf{p}$ :

$$\sigma(X, \mathbf{p}) \equiv v(X) - \sum_{i \in X} p_i. \quad (1)$$

In the next section we describe a broad characterization that encompasses many SAA bidding strategies in the prior literature, as well as a new category of strategies we propose subsequently. Then we describe two bidding methods from the prior literature that are special cases of the general class. One of these extant methods is itself a strategy family, with bidding behavior that varies dramatically depending on the choice of a continuous parameter, so these prior strategies we analyze represent substantial variation. In Section 4 we propose a new bidding approach, which falls into the same broad characterization, but represents yet another substantial variation on the range of strategies we evaluate. This new, price prediction-based strategy family itself encompasses a wide range of methods for generating and using price predictions, which we explore in subsequent sections.

Heuristic strategies are sometimes motivated by bounded rationality [Gigerenzer and Selten, 2001], in which case the primary concern is behavioral realism. Our appeal to heuristics is in the spirit of Rosenthal’s approach to defining games over “rule-of-thumb” strategies [Rosenthal, 1993a,b]. Given the intractability of exhaustive consideration of the full strategy space, we rely on heuristics to represent key strategic ideas in our domain. Behavioral models may be one source of heuristic elements, though explicit optimization procedures or other sophisticated reasoning may be incorporated in our heuristics as well when they are motivated by potential performance gains.

### 3 Perceived-Price Bidding Strategies

If an agent knew the final prices of all  $m$  goods and if those prices did not depend on its own bidding strategy, then its optimal strategy would be clear: bid on a

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<sup>2</sup>Assuming that agents submit bids for a subset of goods at the minimum increment, the size of the strategy space is  $|\mathcal{B}|2^m$ . Conditioning on a history of length  $t$  would expand this space by a factor of  $2^{mt}$ .

subset of goods that maximizes its surplus at known prices. When prices are uncertain or bid-dependent, this is not optimal, but may nevertheless serve as a useful starting point. In this section, we define a class of bidding strategies that generalizes this approach by selecting a subset of goods that maximizes surplus at *perceived* prices.

**Definition 1 (Perceived-Price Bidder)** A perceived-price bidder is parametrized by a perceived-price function  $\rho: \mathcal{B} \rightarrow \mathbb{Z}_*^m$  which maps the agent’s information state,  $\mathbf{B}$ , to a (nonnegative, integer) perceived-price vector,  $\rho(\mathbf{B})$ . It computes the subset of goods

$$X^* = \arg \max_X \sigma(X, \rho(\mathbf{B}))$$

breaking ties in favor of smaller subsets and lower-numbered goods.<sup>3</sup> Then, given  $X^*$ , the agent bids  $b_i = \beta_i + 1$  (the ask price) for the  $i \in X^*$  that it is not already winning.

A perceived-price bidding strategy is defined by how the agent constructs the perceived price from its information state. We now define two versions of the function  $\rho$ , corresponding to perceived-price bidding strategies well-studied in prior literature. In Section 4 we define the newer price-prediction perceived-price strategies we analyze in this article. Our discussion focuses on the particularly challenging case of superadditive preference—complementary goods. We return to address the case of substitutable goods in Section 7.

### 3.1 Straightforward Bidding

One example of a perceived-price bidder is the widely studied *straightforward bidding* (SB) strategy.<sup>4</sup> An SB agent sets  $\rho(\mathbf{B})$  to *myopically perceived prices*: the bid price for goods it was winning in the previous round and the ask price for

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<sup>3</sup>More precisely: when multiple subsets tie for the highest surplus, the agent chooses the smallest. If the smallest subset is not unique it picks the subset whose bit-vector representation is lexicographically greatest. (The bit-vector representation  $\omega$  of  $X \subseteq \{1, \dots, m\}$  has  $\omega_i = 1$  if  $i \in X$  and 0 otherwise. For example, the bit-vector representation of  $\{1, 3\} \subseteq \{1, 2, 3\}$  is  $\langle 1, 0, 1 \rangle$ .) This tie-breaking scheme is somewhat arbitrary, and we expect alternative choices would be inconsequential. We describe our version here in detail to facilitate replication of our experimental results.

<sup>4</sup>We adopt the terminology introduced by Milgrom [2000]. The same concept is also referred to as “myopic best response”, “myopically optimal”, and “myoptimal” [Kephart et al., 1998].

the others:

$$\rho_i(\mathbf{B}) = \begin{cases} \beta_i & \text{if winning good } i \\ \beta_i + 1 & \text{otherwise,} \end{cases} \quad (2)$$

where  $\beta$  is the current bid prices.

Straightforward bidding is a reasonable strategy in some environments. When all agents have single-unit demand, and value every good equally (i.e., the goods are all 1:1 perfect substitutes), the situation is equivalent to a problem in which all buyers have an inelastic demand for a single unit of a homogeneous commodity. For this problem, Peters and Severinov [2006] show that straightforward bidding is a perfect Bayes-Nash equilibrium.

If agents have additive utility, i.e.,  $v(Y) = \sum_{i \in Y} v(\{i\})$ , then they can treat the auctions as independent and in this case too, SB is in equilibrium. To see this, consider the case that all other agents are playing SB with additive preference. Then your bid in one auction does not affect your surplus in another. This implies the auctions can be treated independently and SB is a best response.

The degenerate SAA with  $m = 1$ , i.e., a single ascending auction, is strategically equivalent to a second-price sealed-bid auction [Vickrey, 1961]. In other words, SB is a weakly dominant strategy in a single ascending auction, similarly to “truth-telling” in a second-price sealed-bid auction.<sup>5</sup> For  $m > 1$ , however, the joint strategy space allows *threats* such as “if you raise the price on my good I will raise it on yours.” These will then support demand-reduction equilibria, even in the additive case. Thus, although SB is a good strategy and is in equilibrium for some special-case environments without complementarities, it is not (even weakly) dominant.

Up to a discretization error, the allocation in an SAA with single-unit demand is efficient when agents follow straightforward bidding. It can also be shown [Bertsekas, 1992, Wellman et al., 2001] that the final prices will differ from the minimum unique equilibrium prices by at most  $\min(m, n)$  times the bid increment. The value of the allocation, defined to be the sum of the bidder surpluses, will differ from the optimal by at most the bid increment times  $\min(m, n)(1 + \min(m, n))$ .

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<sup>5</sup>Technically, this equivalence applies to a strategically restricted version of the ascending auction which does not allow arbitrary bids above the ask price (and raises the ask price continuously rather than discretely). Otherwise, there exist strategies (albeit pathological) to which SB is not a best response. For example, suppose my policy is to not bid more than \$100 unless the bidding starts lower, in which case I will keep bidding indefinitely. The best response to such a strategy requires *jump bidding*.

Unfortunately, none of these properties hold for general preferences. The final SAA prices can differ from the minimum equilibrium price vector, and the allocation value can differ from the optimal, by arbitrarily large amounts [Wellman et al., 2001]. And most importantly, SB need not be a Nash equilibrium.

	$v(\{1\})$	$v(\{2\})$	$v(\{1, 2\})$
Agent 1	20	20	20
Agent 2	0	0	30

Table 1: A simple problem illustrating the pitfalls of SB (Example 1).

**Example 1** *There are two agents, with values for two goods as shown in Table 1. One admissible straightforward bidding path<sup>6</sup> leads to a state in which agent 2 is winning both goods at prices (15,14). Then, in the next round, agent 1 would bid 15 for good 2. The auction would end at this point, with agent 1 receiving good 2 and agent 2 receiving good 1, both at a price of 15.*

In this example, SB leads to a result with total allocation value 20, whereas the optimal allocation would produce a value of 30. We can construct slightly more complex examples by adding goods and agents, enabling us to magnify the suboptimality to an arbitrary degree.

We see that straightforward bidding fails to guarantee high quality allocations. It is also easy to show that straightforward bidding is not an equilibrium strategy in general. Consider again Example 1. If agents follow the SB strategy, the mechanism reaches quiescence at prices  $\{15, 15\}$ . However, it is not rational for agent 2 to stop at this point. If, for example, agent 2 continued bidding, prices would reach  $\{21, 20\}$  with agent 2 winning both goods, and the auction would end (assuming agent 1 plays SB). Agent 2 would be better off, with a surplus of  $-11$  rather than  $-15$ .

It is clear that SB is not a reasonable candidate for a general strategy in SAA. We show next how a simple parametric generalization to SB can address a key strategic shortfall.

### 3.2 Sunk-Aware Bidding

Another example of perceived-price bidding is the sunk-aware family of bidding strategies. We showed in Example 1 that in some problems agents following a

<sup>6</sup>The realized progression of the SAA protocol depends on tie-breaking.

straightforward bidding strategy may stop bidding prematurely. To motivate the alternative sunk-aware approach, we consider why SB is failing in this situation. In a given round, agents following SB bid on the set of goods that maximizes their surplus at myopically perceived prices (current bid or ask prices). If none of the nonempty subsets of goods appear to yield positive net surplus, the agent chooses the empty set, i.e., it does not bid at all, because the alternative is to earn negative surplus. However, this behavior ignores outstanding commitments: the agent may already be winning one or more goods. If the agent drops out of the bidding, and others do not bid away the goods the agent already is winning, then its alternative surplus could be much worse than if it continued to bid despite preferring the empty bundle at current prices. In the case of an agent dropping out of the bidding on some goods in a bundle of perfect complements, its surplus is negative the sum of the bid prices for the goods in the bundle it gets stuck with. This failure of straightforward bidding is due to ignoring the true opportunity cost of not bidding.

We refer to this property of straightforward bidding as “sunk-unawareness” [Reeves et al., 2005]. SB agents bid as if the incremental cost for goods they are currently winning is the full price,  $\beta_i$ . However, if the probability that someone else will outbid the agent for this good is  $\alpha$ , then the agent is already committed to an expected payment of  $(1 - \alpha)\beta_i$ . This represents a sunk cost that should not affect rational continuation bidding. We can think of the difference,  $\alpha\beta_i$ , as a rough measure of the incremental cost the agent incurs by deciding to stay with this good.

To address this limitation of straightforward bidding, we parametrize an alternative family of perceived-price bidding strategies (Definition 1) that permits agents to account to a greater or lesser extent for the true incremental cost of goods they are currently winning. We call this strategy “sunk aware”. A sunk-aware agent bids as if the incremental cost for goods it is currently winning is somewhere on the interval of zero and the current bid price.

Our sunk-aware strategies generalize SB’s method for choosing the perceived-price vector (Equation 2) through the parameter  $k \in [0, 1]$ :

$$\rho_i(\mathbf{B}) = \begin{cases} k\beta_i & \text{if winning good } i \\ \beta_i + 1 & \text{otherwise.} \end{cases}$$

Using this perceived-price vector to define sunk-aware bidders, Definition 1 above gives us a complete specification of the agent’s bidding strategy. If  $k = 1$  the strategy is identical to straightforward bidding. At  $k = 0$  the agent is fully sunk aware, bidding as if it would retain the goods it is currently winning with certainty. Inter-

mediate values are akin to bidding as if the agent puts an intermediate probability on the likelihood of retaining the goods it is currently winning. We treat as a special case agents with single-unit demand: their sunk-aware strategy is to bid straightforwardly ( $k = 1$ ) since for such agents SB is a no-regret strategy.

The sunk-awareness parameter provides a heuristic for a complex tradeoff: the agent’s bidding behavior changes after it finds itself exposed to the underlying problem (owning goods for which the agent has lower value if not part of a larger package). In our previous study we experimentally determined good settings of the sunk-awareness parameter in various environments [Reeves et al., 2005].

## 4 Prediction-Based Perceived-Price Bidding

Straightforward and sunk-aware bidding represent alternative SAA bidding strategies, distinguished by the way in which bidders formulate “perceived prices” that determine the items on which they bid. In this section we propose yet another class of bidding strategies: price prediction bidding. In this heuristic approach, bidders form predictions of final prices in order to select the items on which they will bid in a given round.

Whenever an agent has non-substitutes preference and chooses to bid on a bundle of size greater than one, it may face exposure. Exposure in SAA is a direct tradeoff: bidding on a needed good increases the prospects for completing a bundle, but also increases the expected loss in case the full set of required goods cannot be acquired. A decision-theoretic approach would account for these expected costs and benefits, bidding when the benefits prevail, and cutting losses in the alternative.

Re-consider agent 2’s plight in Example 1: following SB it is caught by the exposure problem, stuck with a useless good and a surplus of  $-15$ . (Other tie-breaking choices result in different outcomes but all of them leave agent 2 exposed and with negative surplus.) If the agent instead plays a fully sunk-aware strategy the result could be an outcome in which it purchases both goods at prices  $\{21, 20\}$  for a net surplus of  $30 - 41 = -11$ . This is better than using SB, but the agent would fare better still by not bidding at all.

The effectiveness of a particular strategy will in general be highly dependent on the characteristics of other agents in the environment. This observation motivates the use of *price prediction*. We would prefer strategies that employ type-distribution beliefs to guide bidding behavior, rather than relying only on current price information as in the sunk-aware strategies (including SB). Forming price

predictions for the goods in SAA is a natural use for type-distribution beliefs. In Example 1, suppose agent 2 could predict with certainty before the auctions start that the prices would total at least 30. Then it could conclude that bidding is futile, not participate, and avoid the exposure problem altogether. Of course, agents will not in general make perfect predictions. However, we find that even modestly informed predictions can significantly improve performance.

We now propose to improve on SB and sunk-aware bidding by using explicit price predictions for perceived prices. Let  $F \equiv F(\mathbf{B})$  denote a joint cumulative distribution function over final prices, representing the agent’s belief given its current information state  $\mathbf{B}$ . We assume that prices are bounded above by a known constant,  $V$ . Thus,  $F$  associates probabilities with price vectors in  $\{1, \dots, V\}^m$ .

We next consider two ways to use prediction information to generate perceived prices. We first define a *point prediction*  $\pi$ , which anticipates possible exposure risks. Then we define a *distribution prediction*  $F$  that explicitly models uncertainty about the exposure prospects. The distribution prediction generates perceived incremental prices,  $\Delta$ , which account for the likelihood that the agent’s current winning bids are sunk costs. As with sunk-awareness, price-prediction strategies for agents with single-unit demand ignore the predictions and play SB.

Before we define our price-prediction strategies we want to make two points. First, we are not (initially) concerned with *how* the agent formulates her beliefs (price predictions), nor the optimality of the prediction method. Rather, we propose strategies that use *some* beliefs. In our experiments we investigate several different predictors.<sup>7</sup> Second, since these are strategies for bidding in iterative auctions, we face the question of how to update the initial price predictions based on information revealed during the bidding process. We do not insist here on identifying the optimal updating procedure; again, we define strategies that incorporate *some* belief updating procedure. Whereas we experiment with different initial price predictors, in this paper we employ only one specific, simple, updating procedure.

## 4.1 Point Price Prediction

Suppose the agent has (at least) point beliefs about the final prices that will be realized for each good. Let  $\pi(\mathbf{B})$  be a vector of predicted final prices. Before the

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<sup>7</sup>We believe that finding the *optimal* predictor to use in a particular strategy is likely to be as computationally infeasible as the problem of finding an optimal strategy.

auctions begin the price prediction is  $\pi(\emptyset)$ , where  $\emptyset$  is the null information state available pre-auctions.

The auctions in SAA reveal the bid prices each round. Since the auctions are ascending, once the current bid price for good  $i$  reaches  $\beta_i$ , there is zero probability that the final price  $p_i$  will be less than  $\beta_i$ . We define a simple updating rule using this fact: the current price prediction for good  $i$  is the maximum of the initial prediction and the myopically perceived price:

$$\pi_i(\mathbf{B}) \equiv \begin{cases} \max(\pi_i(\emptyset), \beta_i) & \text{if winning good } i \\ \max(\pi_i(\emptyset), \beta_i + 1) & \text{otherwise.} \end{cases} \quad (3)$$

Armed with these predictions, the agent plays the perceived-price bidding strategy (Definition 1) with  $\rho(\mathbf{B}) \equiv \pi(\mathbf{B})$ . We denote a specific point price-prediction strategy in this family by  $\text{PP}(\pi^x)$ , where  $x$  labels particular initial prediction vectors,  $\pi(\emptyset)$ . Note that straightforward bidding is the special case of price prediction with the predictions all equal to zero:  $\text{SB} = \text{PP}(\mathbf{0})$ . If the agent underestimates the final prices, it will behave identically to SB after the prices exceed the prediction. If the agent overestimates the final prices, it may stop bidding prematurely.

## 4.2 Distribution Price Prediction

We generalize the class of price-prediction strategies by taking into account the entire distribution  $F$ , rather than just a nominal point estimate (e.g., the expectation of  $F$ ). We assume the agent generates  $F(\emptyset)$ , an initial, pre-auction probabilistic belief about the final prices.

As with the point predictor, we restrict the updating in our distribution predictor to conditioning the distribution on the fact that prices are bounded below by  $\beta$ . Let  $\Pr(\mathbf{p} \mid \mathbf{B})$  be the probability, according to  $F$ , that the final price vector will be  $\mathbf{p}$ , conditioned on the information revealed by the auction,  $\mathbf{B}$ . Then, with  $\Pr(\mathbf{p} \mid \emptyset)$  as the pre-auction initial prediction, we define:

$$\Pr(\mathbf{p} \mid \mathbf{B}) \equiv \begin{cases} \frac{\Pr(\mathbf{p} \mid \emptyset)}{\sum_{\mathbf{q} \geq \beta} \Pr(\mathbf{q} \mid \emptyset)} & \text{if } \mathbf{p} \geq \beta \\ 0 & \text{otherwise.} \end{cases} \quad (4)$$

(By  $\mathbf{x} \geq \mathbf{y}$  we mean  $x_i \geq y_i$  for all  $i$ .) For (4) to be well defined for all possible  $\beta$  we define the price upper bounds such that  $\Pr(V, \dots, V \mid \emptyset) > 0$ .

We now use the distribution information to implement a further enhancement to take sunk costs into account in a more decision-theoretic way than the sunk-aware agent. If an agent is currently not winning a good and bids on it, then the expected incremental cost of winning the good is the expected final price, with the expectation calculated with respect to the distribution  $F$ . If the agent is currently winning a good, however, then the expected incremental cost of winning that good depends on the likelihood that the current bid price will be increased by another agent, so that the first agent has to bid again to obtain the good. If, to the contrary, it keeps the good at the current bid, the full price is sunk (already committed) and thus should not affect incremental bidding. Based on this logic we define  $\Delta_i(\mathbf{B})$ , the expected *incremental* price for good  $i$ .

First, for simplicity, we use only the information contained in the vector of marginal distributions,  $(F_1, \dots, F_m)$ , as if the final prices were independent across goods. Define the expected final price conditional on the most recent vector of bid prices,  $\beta$ :

$$E_F(p_i | \beta) = \sum_{q_i=0}^V \Pr(q_i | \beta_i) q_i = \sum_{q_i=\beta_i}^V \Pr(q_i | \beta_i) q_i.$$

The expected incremental price depends on whether the agent is currently winning good  $i$ . If not, then the lowest final price at which it could win is  $\beta_i + 1$ , and the expected incremental price is simply the expected price conditional on  $p_i \geq \beta_i + 1$ ,

$$\Delta_i^L(\mathbf{B}) \equiv E_F(p_i | p_i \geq \beta_i + 1) = \sum_{q_i=\beta_i+1}^V \Pr(q_i | p_i \geq \beta_i + 1) q_i. \quad (5)$$

If the agent is winning good  $i$ , then the incremental price is zero if no one outbids the agent. With probability  $1 - \Pr(\beta_i | \beta_i)$  the final price is higher than the current price, and the agent is outbid with a new bid price  $\beta_i + 1$ . Then, to obtain the good to complete a bundle, the agent will need to bid at least  $\beta_i + 2$ , and the expected incremental price is

$$\Delta_i^W(\mathbf{B}) = (1 - \Pr(\beta_i | \beta_i)) \sum_{q_i=\beta_i+2}^V \Pr(q_i | \beta_i + 2) q_i.$$

The vector of expected incremental prices is then defined by

$$\Delta_i(\mathbf{B}) = \begin{cases} \Delta_i^W(\mathbf{B}) & \text{if winning good } i \\ \Delta_i^L(\mathbf{B}) & \text{otherwise.} \end{cases}$$

The agent then plays the perceived-price bidding strategy (Definition 1) with  $\rho(\mathbf{B}) \equiv \Delta(\mathbf{B})$ . We denote the strategy of bidding based on a particular distribution prediction by  $\text{PP}(F^x)$ , where  $x$  labels various pre-auction distribution predictions,  $F(\emptyset)$ .

To recapitulate, in this and the previous section we have formally specified three categories of bidding strategies, encompassed within a single broad but flexible class we call “perceived price” bidding. The first two, straightforward and sunk-aware bidding, have been explored in prior literature; the third, price-prediction bidding, is new. Both sunk-aware and price-prediction are families that admit a wide range of specific strategies, and thus represent a variety of actual bidding behaviors.<sup>8</sup> For the generic SAA we study, when bidders have non-substitute preferences but face exposure (but not other problems such as budget constraints), we think this broad set of strategy candidates captures most of the existing wisdom about SAA strategy design.

In Section 6 we intensively analyze and compare the performance of this broad set of bidding strategies in a series of SAA environments with non-substitute preferences. After that (Section 7) we specify yet another family of strategies, based on prior literature, and perform a strategic analysis over this enlarged set for environments with substitute goods.

## 5 Some Methods for Predicting Prices in SAA

In Section 4 we define bidding strategies based on point price and distribution-based predictions. These are classes of strategies parametrized by the choice of initial prediction: a vector of predicted final prices in the case of the point predictor, or a distribution of final prices for the distribution predictor. We now present several ways to obtain an initial prediction. Each different prediction method generates a different bidding strategy, with potentially different bidding behavior. Furthermore, these methods all take as input the problem’s type distribution, and so (unlike a particular sunk-awareness setting, for example) are potentially appropriate to apply across different environments.

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<sup>8</sup>In the next section we define a variety of different price prediction methods, each leading to different bidding behavior.

## 5.1 Predictions from Simulated Data

One natural method for generating an initial prediction is to fix a particular strategy profile, and simulate the play of this profile for a large number of games by sampling agent valuations from the underlying type distribution. From this set of simulated games, we can observe the resulting prices, and use these as a basis for prediction. For a point price prediction, we simply compute the average final prices over the simulation experience, and for a distribution-based prediction we compute final price histograms. This yields a large family of prediction-based strategies, each member distinguished by its form of predictor (point vs. distribution), and by the strategy profile employed in simulation to generate the price data.

As a noteworthy special case of the above, our baseline prediction is the distribution of final prices resulting when all agents follow the SB strategy. We denote the baseline point predictor  $PP(\pi^{\text{SB}})$  and the baseline distribution predictor  $PP(F^{\text{SB}})$ .

As noted above, these prediction strategies, and others presented below, take the type distribution as input to the simulation process. Thus, in order to use this method in practice, agents (who know only their own valuation function) need to employ probabilistic beliefs over the valuation functions for other agents. The advantage of this approach is that the methods themselves can be applied to a range of environments by modifying this type-distribution input, without any further parameter tuning required.

## 5.2 Walrasian Equilibrium for Point and Distribution Prediction

An alternative, competitive-analysis approach is to use as predictions the prices that would obtain *if* the market were to reach a *Walrasian price equilibrium* with respect to the  $m$  goods and agent valuation functions over those goods. In another complex bidding setting, we have found that predictions based on competitive equilibrium can be surprisingly effective, achieving accuracy comparable to sophisticated machine learning approaches [Wellman et al., 2004]. We emphasize that our appeal to competitive equilibrium in this context is purely heuristic; we are not assuming as analysts that the equilibrium is realized, but rather employing the well-defined equilibrium concept as a means to generate price predictions for use in bidding.

One immediate complication that underscores the distinction is that Walrasian

prices need not actually exist in our setting. Consider once again the  $m = n = 2$  configuration of Example 1 (Table 1). Versions of this example, in which one agent views the goods as complements and the other as substitutes, are commonly employed to illustrate the absence of a competitive equilibrium [Cramton, 2005, McAfee and McMillan, 1996]. There exist no prices for goods 1 and 2 such that both agents optimize their demands at the specified prices and the markets clear. General conditions for existence of price equilibria given discrete goods are provided by Bikhchandani and Mamer [1997].

To deal with this problem, we specify the Walrasian prediction strategy operationally, just as we do the simulation-based predictors presented in Section 5.1. That is, we define the “equilibrium” prices to be those produced after a specified number of iterations of some designated price-adjustment protocol, applied to the environment corresponding to the given SAA game. Although this construction does not guarantee the prices employed are actually in equilibrium (indeed, such guarantee is not possible), it does ensure that the prediction strategy is well-defined.

Another complication is that the standard definition of Walrasian equilibria presumes deterministic demand functions, whereas in our setting we are faced with probability distributions over agent valuations. We can generalize the price-equilibrium calculation in two ways to allow for probabilistic knowledge of the aggregate demand function. The first is to find the *expected price equilibrium* (EPE): the expectation (over the type distribution) of the Walrasian price-equilibrium vector. The most straightforward way to estimate this is Monte Carlo simulation, sampling from the type distribution. A particular sampled type determines the demand function  $\mathbf{x}$ , which we can then employ in a tâtonnement protocol. Let  $\mathbf{p}^t$  denote the price vector at iteration  $t$ , and  $\alpha^t$  an adjustment parameter that decays with  $t$ . The standard tâtonnement procedure [Arrow and Hahn, 1971] applied to the SAA setting (one unit of each good available) iteratively revises the price vector according to the following difference equation:

$$\mathbf{p}^{t+1} = \mathbf{p}^t + \alpha^t[\mathbf{x}(\mathbf{p}^t) - \mathbf{1}]. \quad (6)$$

Repeated sampling of types and application of (6) yields a crude Monte Carlo estimate of the expected price equilibrium.

An alternative (which may sometimes be preferred for computational reasons) to estimating a price equilibrium in the face of probabilistic demand is the *expected-demand price equilibrium* (EDPE): the Walrasian price equilibrium with respect to expected aggregate demand. In other words, we calculate or estimate

the expected demand function and then apply tâtonnement once to find an equilibrium as if realized demand were in fact equal to expected demand. We calculate expected demand analytically when possible [Cheng et al., 2005]; otherwise, we can estimate it by Monte Carlo simulation, again sampling from the type distribution.

Either of these generalized Walrasian price-equilibrium methods can be applied to generate point predictions. We denote the expected price-equilibrium point predictor by  $PP(\pi^{\text{EPE}})$  and the expected-demand price-equilibrium point predictor by  $PP(\pi^{\text{EDPE}})$ . The method of expected price equilibrium can also be straightforwardly generalized—by tracking the empirical distribution of price equilibria instead of just average prices—to the case of distribution predictor, yielding  $PP(F^{\text{EPE}})$ .<sup>9</sup>

### 5.3 Self-Confirming Price Predictions

Our final class of prediction methods combines the spirit of simulation-based and equilibrium-based approaches. The basic idea is to estimate prices under the assumption that agents will follow prediction strategies with accurate price predictions. We refer to these as *self-confirming* predictions. We begin with the simpler case of point predictions.

**Definition 2 (Self-Confirming Point Price Prediction)** *Let  $\Gamma$  be an instance of an SAA game. The prediction  $\pi$  is a self-confirming prediction for  $\Gamma$  iff  $\pi$  is equal to the expectation (over the type distribution) of the final prices when all agents play  $PP(\pi)$ .*

In other words, if all agents use a point price-prediction strategy, then the self-confirming predictions are those that on average *are correct* at the end of the auction.<sup>10</sup> We denote the self-confirming prediction vector by  $\pi^{\text{SC}}$  and the self-confirming point prediction strategy by  $PP(\pi^{\text{SC}})$ .

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<sup>9</sup>Unlike the EPE method, which produces a price vector for each sample from the type distribution, the EDPE-method price data is always a single price vector, because tâtonnement is applied only once at the last step. Therefore, we did not construct *distribution* price-prediction strategies based on the latter.

<sup>10</sup>As described above, our price-prediction strategies perform simple updating based on price-quote information as the auction proceeds. Our self-confirmation notion, however, applies only to initial predictions and final prices—we do not insist that the intermediate updated predictions are also confirmed.

The key feature of self-confirming predictions is that agents make decisions based on predictions that turn out to be correct with respect to the type distribution and the assumption that all agents play this particular prediction strategy.<sup>11</sup> Since agents are employing these predictions strategically, we might reasonably expect the strategy to perform well in an environment where its predictions are confirmed.

We next define the concept of a self-confirming *distribution* of final prices in SAA.

**Definition 3 (Self-Confirming Price Distribution)** *Let  $\Gamma$  be an instance of an SAA game. The prediction  $F$  is a self-confirming price distribution for  $\Gamma$  iff  $F$  is the distribution of prices resulting when all agents play bidding strategy  $PP(F)$ .*

The actual joint distribution will in general have dependencies across prices for different goods. We are also interested in the situation in which if the agents play a strategy based just on marginal distributions, that resulting distribution has the same marginals, despite dependencies.

**Definition 4 (Self-Confirming Marginal Distribution)** *Let  $\Gamma$  be an instance of an SAA game. The prediction  $F = (F_1, \dots, F_m)$  is a vector of self-confirming marginal price distributions for  $\Gamma$  iff for all  $i$ ,  $F_i$  is the marginal distribution of prices for good  $i$  resulting when all agents play bidding strategy  $PP(F)$  in  $\Gamma$ .*

### 5.3.1 Existence of Self-Confirming Predictions

We demonstrate in Section 5.3.2 that we can often find approximately self-confirming point and distribution predictions. However, we first observe that they do not always exist, for the same reason that Walrasian prices may not exist.

**Proposition 1** *There exist SAA games for which no self-confirming point price prediction exists, nor do any self-confirming or marginally self-confirming price distributions.*

*Proof.* Define an SAA game corresponding to the configuration of Table 1. Recall the argument in Section 5.2 that there are no Walrasian prices for this example. Given a deterministic SAA mechanism (one without asynchrony or random tie-breaking), for fixed value functions the outcome from playing any profile of deterministic trading strategies is a constant. Thus, the only possible self-confirming

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<sup>11</sup>An equilibrium with this feature is sometimes called a “fulfilled expectations equilibrium” [Novshek and Sonnenschein, 1982].

distributions (which were defined for agents playing the deterministic PP( $F$ ) strategies) must assign probability one to the actual resulting prices. But given such a prediction, our trading strategy will pursue the agent's best bundle at those prices, and must actually get them since the prices are correct if the distribution is indeed self-confirming. But then the markets would all clear, contrary to the fact that the predicted prices cannot constitute an equilibrium, since such prices do not exist in this instance.  $\square$

Despite this negative finding, we conjecture that price distributions that are self-confirming to a reasonable degree of approximation exist for a large class of nondegenerate preference distributions, and can be computed given a specification of the preference distribution. For instance, in Example 2 below we demonstrate that if the preference distribution is such that any particular preference profile is a different variation of Example 1 rather than a fixed configuration, approximate self-confirming point price predictions may exist even though Walrasian prices do not exist in any game instance. We also show in Section 5.3.2 that approximate marginal self-confirming price distributions may also exist in games with such preferences. We now present a procedure for deriving self-confirming distributions, and some evidence for its effectiveness.

### 5.3.2 Deriving Self-Confirming Price Predictions

To find approximate self-confirming point predictions, we follow a simple iterative procedure. First, we initialize the predicting agents with some prediction vector (e.g., all zero) and simulate many game instances with the all-predict profile. When average prices obtained by these agents are determined, we replace the initial prediction vector with the average prices and repeat. When this process reaches a fixed point, we have the self-confirming prediction,  $\pi^{\text{SC}}$ .

**Example 2** *There are  $n \geq 2$  agents and  $m \geq 2$  goods. Agent 1 has single-unit demand, and the value of each good is  $v_1 > 0$ . The rest of the agents each need all the goods in order to obtain any value. For  $i \neq 1$ , agent  $i$ 's value for the  $m$ -good set is  $v_i$ , such that*

$$v_1 < v_i < mv_1. \tag{7}$$

*Let  $v_1, \dots, v_i, \dots$  be chosen probabilistically from a given type distribution satisfying condition (7).*

The values in Table 1 are an example of preferences satisfying condition (7). As for that example, no Walrasian equilibrium prices exist for any combination

of  $v_1$  and  $v_i$  consistent with the condition. However, because self-confirming predictions are *expectations* over the type distribution, non-existence of equilibrium prices for specific preferences does not imply non-existence of self-confirming prices with respect to the *ex ante* distribution. In Figure 1 we show the convergence to a self-confirming price-prediction vector for Example 2, for a particular distribution and various numbers of agents and goods. In three out of four such SAA games we analyzed, the prices converged within 10 iterations. In the game with two agents and five goods (Panel (c)), there is some persistent oscillation, but the prices stay within 0.5% of the upper bound on a single good value  $V$ .

In cases of price oscillation, we found that by resetting the vector of predicted prices to equal the averages around which the prices are fluctuating, the process often immediately converges to a more precise fixed point. We used this method to construct  $\pi^{\text{SC}}$  for the SAA game presented in Section 6.2.

A similar approach can be applied to derive distribution predictions. Starting from an arbitrary prediction  $F^0$ , we run many SAA game instances (sampling from the given preference distributions) with all agents playing strategy  $\text{PP}(F^0)$ .<sup>12</sup> We record the resulting prices from each instance, and designate the sample distribution observed by  $F^1$ .<sup>13</sup> We repeat the process using the new distribution  $F^t$  for iteration  $t + 1$  for some further series of iterations. If it ever reaches an approximate fixed point, with  $F^t \approx F^{t+1}$  for some  $t$ , then we have statistically identified an approximate self-confirming price distribution for this environment.

We employ the Kolmogorov-Smirnov (KS) statistic as one reasonable measure of similarity of probability distributions, defined as the maximal distance between any two corresponding points in the CDFs:

$$KS(F, F') = \max_x |F(x) - F'(x)|.$$

For self-confirming marginal distributions, we take the maximum of the KS distances measured separately for each good:  $KS_{\text{marg}} = \max_i KS(F_i, F'_i)$ .

Specifying our procedure requires (i) a number of samples per iteration, (ii) a threshold on  $KS$  or  $KS_{\text{marg}}$  on which to halt the iterations and return a result, (iii) a maximum number of iterations in case the threshold is not met, and (iv) a

<sup>12</sup>In most of our experiments, the initial prediction is uniformly distributed prices between 0 and the upper bound,  $V$ , on the value of a single good, but our results do not appear sensitive to this.

<sup>13</sup>In order to ensure that conditioning on information state during bidding is always well defined, we modify the observed distribution to add uniform infinitesimal probability for all price vectors greater than those observed in samples.

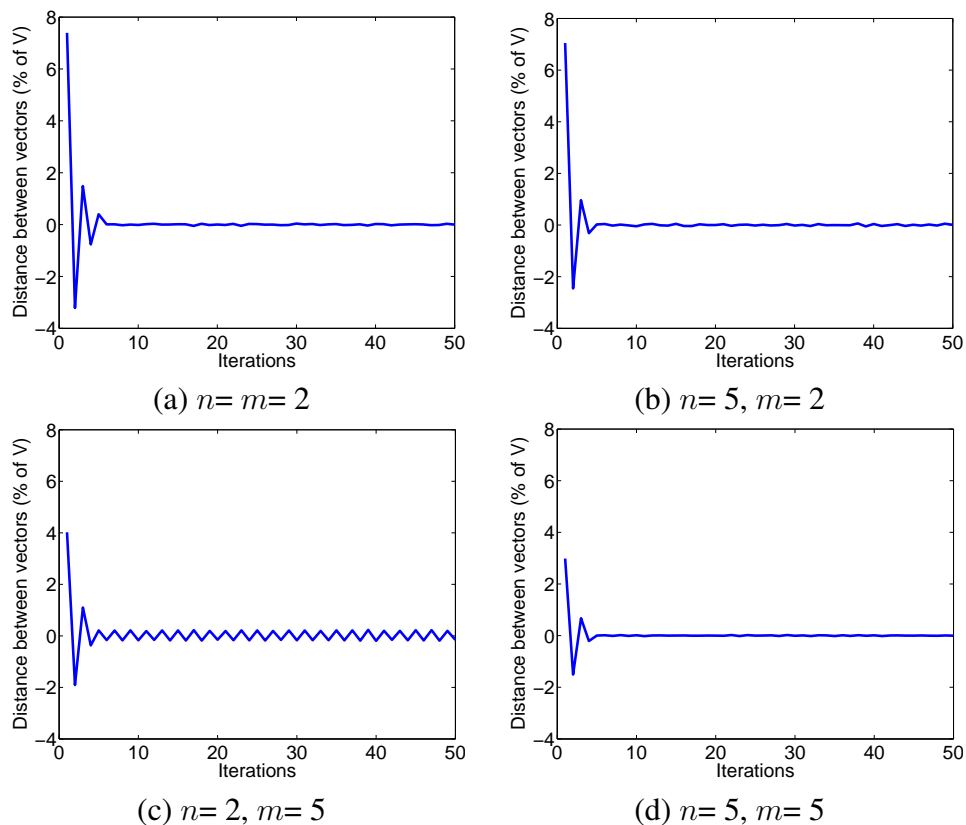


Figure 1: Convergence of iterative estimation of self-confirming price-prediction vectors in environments in which no Walrasian equilibrium prices exist. The scenarios are instances of Example 2, with  $v_1 \sim U[3, V - 1]$ ,  $V = 50$ , and each  $v_i \sim U[v_1 + 1, \min(m(v_1 - 1), V)]$ . The initial prediction is that all prices would be zero, with prices at subsequent iterations determined by a million simulated games at the previous predicted price. The graph plots the distance between the price vectors in consecutive iterations. We define vector distance as the maximum over pointwise distances, measured as a percentage of the upper bound,  $V$ , on the value of a single good.

smoothing parameter designating a number of iterations to average over when the procedure reaches the maximum iterations without meeting the threshold. The bound on the number of iterations ensures the procedure terminates and returns a price distribution, which may or may not be self-confirming. When this occurs, the smoothing parameter avoids returning a distribution that is known to cause oscillation. We do not, of course, expect the bidding strategy to perform as well when we cannot find a convergent self-confirming distribution and the underlying oscillations are large.

For our empirical analyses, we specify an SAA game based on a scheduling problem in which there are  $m$  units (called *time slots*) of a single schedulable resource, indexed  $1, \dots, m$ . Each of  $n$  agents has a single job that can be accomplished using the resource. Agent  $j$ 's job requires  $\lambda_j$  time slots to complete, and by accomplishing this job it obtains some value depending on the time it completes. Specifically, if  $j$  acquires  $\lambda_j$  time slots by deadline  $t$ , it accrues value  $v_j(t)$ . Deadline values are nonincreasing:  $t < t'$  implies  $v_j(t) \geq v_j(t')$ .

To illustrate, we consider such a scheduling problem with five agents competing for five time slots. We draw job lengths randomly from  $U[1, 5]$ . We choose deadline values randomly from  $U[1, 50]$  then prune to impose monotonicity [Reeves et al., 2005]. The initial prediction is the baseline distribution prediction  $F^{SB}$ . We set the algorithm parameters at one million games per iteration, and a  $0.01$ - $KS_{\text{marg}}$  convergence criterion. The predicted and empirical distributions quickly converge, with a  $KS_{\text{marg}}$  distance of  $0.007$  after only six iterations.

To see if our method produces useful results with some regularity, we applied it to 26 additional instances of the scheduling problem, varying the numbers of agents and goods, and the preference distributions. The initial prediction in all 26 additional instances is that all prices are uniformly distributed. We again drew deadline values from  $U[1, 50]$  and pruned them for monotonicity. We used two probability models for job lengths in the first 21 instances. In the *uniform* model, they are drawn from  $U[1, m]$ . In the *exponential* model job length  $\lambda$  has probability  $2^{-\lambda}$ , for  $\lambda = 1, \dots, m - 1$ , and probability  $2^{-(m-1)}$  when  $\lambda = m$ .

We constructed 10 instances of the uniform model, comprising various combination of  $3 \leq n \leq 9$  and  $3 \leq m \leq 7$ . In each case, our procedure found self-confirming marginal price distributions ( $KS_{\text{marg}}$  threshold  $0.01$ ) within 11 iterations. Similarly, for 11 instances of the exponential model, with the number of agents and goods varying over the same range, we found SC distributions within 7 iterations. We plot the distribution of  $KS_{\text{marg}}$  values from these 21 instances in Figure 2.

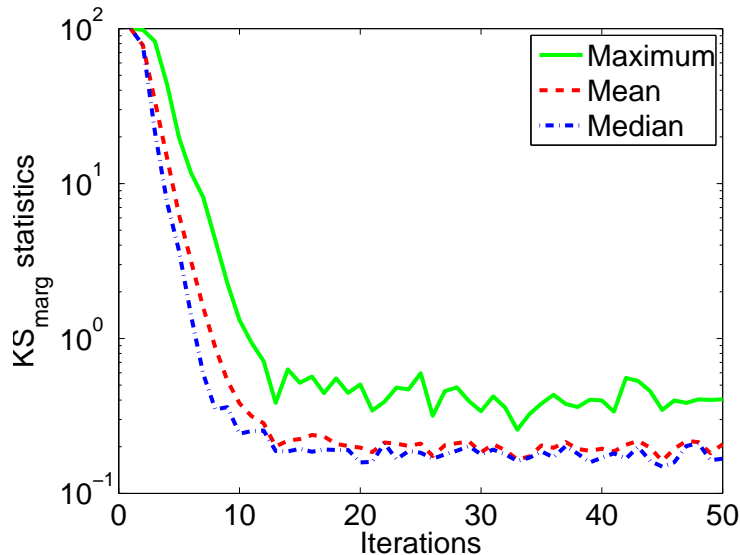


Figure 2: Convergence of iterative estimation of self-confirming marginal price distributions. The initial prediction is that all prices are uniformly distributed. The prices at each iteration are determined by a million simulated games. The graph plots the maximum, mean, and median  $KS_{\text{marg}}$  from 21 instances of the scheduling problem with uniform and exponential preference models.

The 22nd instance was designed to be more challenging: we used the  $n = m = 2$  example with fixed preferences described in Table 1. Since there exists no SC distribution, our algorithm did not find one, and as expected, after a small number of iterations it began to oscillate among a few states indefinitely. After reaching the limit of 100 iterations, our algorithm returned as its smoothed prediction distribution the average over the last 10.

Finally, we also tested the procedure on the four cases of Example 2, employed above (see Figure 1) to evaluate search for self-confirming point predictions. Recall that in these environments, no Walrasian equilibrium prices exist in any instance of the preference distribution. For the cases with the number of goods  $m = 5$  (both  $n = 2$  and  $n = 5$ ), price distributions immediately converged to a self-confirming distribution with the price of the first good equal to one with probability one and the rest of the prices equal to zero. To see that this is self-confirming, note that the agents who need all  $m$  goods will calculate their incremental cost by conditioning on the price being positive (see Equation (5)).

The posterior probability is uniform over all prices (since the condition is greater than any observed prices), which deters all such agents from bidding at all. This is the correct decision from their perspective, as they could not profitably obtain all the goods in the presence of an agent who needs only one and obtains a greater per-good value. For the cases with  $m = 2$ , in contrast, the uniform belief is not always sufficient to keep these agents from bidding initially, and so the prediction of  $p_1 = 1$  and  $p_2 = 0$  is not self-confirming. For these examples, we found that the  $KS_{\text{marg}}$  value during iterative search oscillates in a range of up to 30% of  $V$ .

Though we do not expect self-confirming predictors to always provide excellent predictions (they are, after all, heuristics), these examples indicate that even in a variety of challenging environments (in which Walrasian price equilibria do not exist) they often provide reasonable predictions. Of course, the real test of their value as a method for use in bidding comes from their performance against other bidding strategies. We now turn to the computational evaluation of over 50 strategies in various SAA games.

## 6 Empirical Game Analysis: Complementary Preferences

We now analyze the performance of self-confirming price distribution predictors in a variety of SAA games, against a variety of other strategies. We use Monte Carlo simulation to estimate the payoff function for an *empirical game*, which maps profiles of agent strategies to expected payoffs for each agent. This approach converts a game in extensive form to normal form in the expected payoffs. We then analyze equilibria in these normal forms. Our methods extend the approach developed in our prior work [MacKie-Mason et al., 2004, Reeves et al., 2005, Wellman, 2006], and build on ideas from other recent studies in a similar empirical vein [Armantier et al., 2000, Kephart et al., 1998, Walsh et al., 2002]. We emphasize here that all of the analysis below applies directly to the *estimated* empirical game. These correspond to statistical claims about the actual restricted-strategy game, and lead to arguments generalizing the observations to related games.

## 6.1 Environments and Strategy Space

We studied SAAs applied to market-based scheduling problems, as described in Section 5.3.2. Particular environments are defined by specifying the number  $m$  of goods, the number  $n$  of agents, and a preference model comprising probability distributions over job lengths and deadline values. The bulk of our computational effort went into an extensive analysis of one particular environment: the  $m = n = 5$  uniform model presented above. As described in Section 6.2, the empirical game for this setting provides much evidence supporting the unique strategic stability of  $PP(F^{SC})$ . We complement this most detailed trial with smaller empirical games for a range of other scheduling-based SAA environments. Altogether, we have studied selected environments with uniform, exponential, and fixed distributions for job lengths; a modified uniform distribution for deadline values; and agents in  $3 \leq n \leq 8$ ; goods in  $3 \leq m \leq 7$ .

To varying degrees, we have analyzed the interacting performance of 53 different strategies. These were drawn from four strategy families described above: SB, 20 sunk-aware agents with varying sunk-awareness parameters  $k$ , 13 point predictors, and 19 distribution predictors based on various prediction methods. The price prediction methods include variations of Walrasian equilibrium prediction (nine point and one distribution predictor), historical-data predictions (two point and one distribution), self-confirming predictions (one point and one distribution), and other methods.<sup>14</sup>

The choice of strategies was based on prior experience. We believe that the set includes the best strategy candidates from the prior literature, though we make no claim to have covered all reasonable variations. Naturally, our emphasis is on evaluating the performance of  $PP(F^{SC})$  in combination with the other strategies.

Given  $n$  agents and  $S$  possible strategies, the corresponding symmetric normal-form game comprises  $\binom{n+S-1}{n}$  distinct strategy profiles. The game size thus grows exponentially in  $n$  and  $S$ ; for the  $n = 5$ ,  $S = 53$  game we estimate below, there are over four million different strategy profiles to evaluate. We first illustrate the process for a simpler game, with five agents, each choosing between SB or the baseline point price-prediction strategy  $PP(\pi^{SB})$  (abbreviated PP). There are six possible profiles which can be described as profiles with  $j$  agents playing PP (and the rest SB) for  $j = 0, \dots, 5$ . We simulate a large number of games for each

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<sup>14</sup>Space considerations preclude a full description of the 53 strategies here. An appendix with specification of all parameters, including complete description of all the prediction methods used for point and distribution predictors, is available at <http://hdl.handle.net/2027.42/57741>.

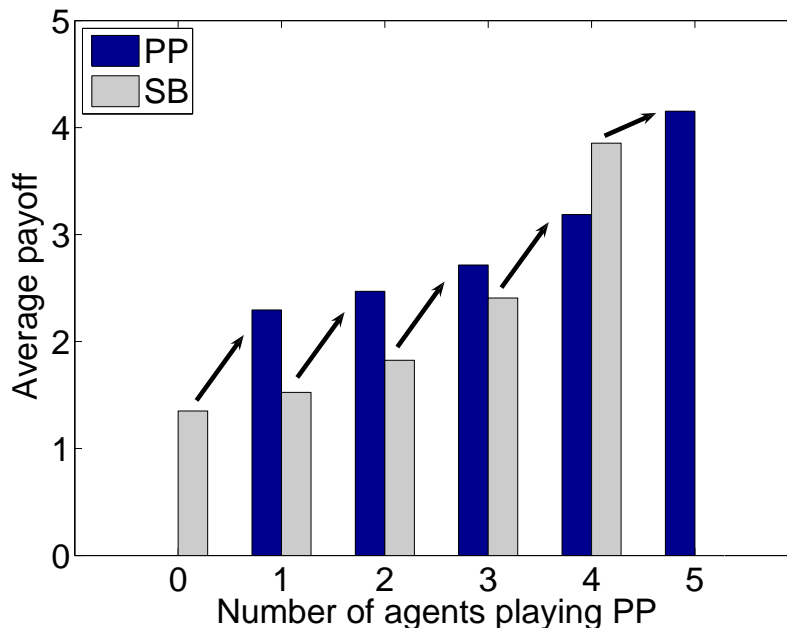


Figure 3: Normal-form payoffs for a 5-player game with 2 strategies. The arrows indicate best responses. All-PP is the unique Nash equilibrium.

profile and average the payoffs for a player of each type (PP, SB). We present the resulting empirical game in Figure 3. For this simple game, we can solve the normal form for a unique pure-strategy Nash equilibrium by inspection, illustrated by the arrows. If all five players choose SB, any one can get a higher expected payoff by deviating to PP. If only one plays PP, a second can beneficially deviate to PP. Likewise for each profile except all playing PP, from which none can gain by deviating to SB, establishing a unique Nash equilibrium.

## 6.2 $5 \times 5$ Uniform Environment

By far the largest empirical SAA game we have constructed is for the SAA scheduling environment discussed in Section 5.3.2, with five agents, five goods, and uniform distributions over job lengths and deadline values. We estimate payoffs empirically for each profile by running millions of simulations of the auction protocol, so estimating the entire payoff function for over 4.2 million strategy profiles is infeasible. However, we can estimate the payoff matrix for subsets of all profiles, and as we describe below, with well-chosen subsets we can reach useful

conclusions about equilibria in the 53-strategy game.

Our results are based on estimated payoffs for 4457 strategy profiles, calculated from an average of 7 million samples per profile (with some profiles simulated for as few as 200 thousand games, and some for as many as 200 million, depending on sampling variances). Despite the sparseness of the estimated payoff function (covering only 0.1% of possible profiles), we have been able to obtain several results.

First, as discussed above, we conjectured that the self-confirming distribution-prediction strategy,  $PP(F^{SC})$ , would perform well. We have directly verified this: *the profile where all five agents play a pure  $PP(F^{SC})$  strategy is a Nash equilibrium of the empirical game.* That is, we verified that no unilateral deviation to any of the other 52 pure strategies is profitable. Note that in order to verify a pure-strategy symmetric equilibrium (all agents playing a strategy  $s$ ) for  $n$  players and  $S$  strategies, one needs only  $S$  profiles: one for each strategy playing against  $n - 1$  copies of  $s$ . Similarly, to refute the possibility of a particular profile being in Nash equilibrium, we need to find only one profitable deviation profile (i.e., obtained by changing the strategy of one player to earn a higher payoff given the others' strategies).

The fact that  $PP(F^{SC})$  is pure symmetric Nash for this game does not of course rule out the existence of other Nash equilibria. Indeed, without evaluating any particular profile, we cannot eliminate the possibility that it represents a (non-symmetric) pure-strategy equilibrium itself. However, the profiles we did estimate provide significant additional evidence, including the elimination of broad classes of potential symmetric mixed equilibria.

Let us define a strategy *clique* as a set of strategies for which we have estimated payoffs for all combinations.<sup>15</sup> Each clique defines a subgame, for which we have complete payoff information. Within our 4457 profiles we have eight maximal cliques that include strategy  $PP(F^{SC})$ . For each of these subgames,  $PP(F^{SC})$  is the only strategy that survives iterated elimination of (strictly) dominated strategies. It follows that  $PP(F^{SC})$  is the *unique* (pure- or mixed-strategy) Nash equilibrium in each of these clique games. We can further conclude that in the full 53-strategy game there are no equilibria with support contained within any of the cliques, other than the special case of the pure-strategy  $PP(F^{SC})$  equilibrium.

Analysis of the available two-strategy cliques (not generally maximal) pro-

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<sup>15</sup>Thus we have a 2-strategy clique if we have estimated all six profiles that five agents can form from these two strategies.

vides further evidence about potential alternative equilibria. Of the  $\binom{52}{2} = 1326$  pairs of strategies not including  $\text{PP}(F^{SC})$ , we have all profile combinations for 49. Based on profiles estimated, we have determined that for any symmetric profile defined by a mixture of one of these pairs, an agent can improve its payoff by a minimum of 0.32 through deviating to some other pure strategy. For reference, the average payoff for the all- $\text{PP}(F^{SC})$  profile is 4.51, so this represents a nontrivial difference.

That is, none of the two-strategy mixtures for which we have data comes very close to equilibrium, further strengthening our confidence in  $\text{PP}(F^{SC})$ .

Finally, for each of the 4457 evaluated profiles, we can derive a bound on the  $\epsilon$  rendering the profile itself an  $\epsilon$ -Nash pure-strategy equilibrium. The three most strategically stable profiles by this measure are:

1. all  $\text{PP}(F^{SC})$ :  $\epsilon = 0$  (confirmed Nash equilibrium of the empirical game);
2. one  $\text{PP}(F^{SB})$ , four  $\text{PP}(F^{SC})$ :  $\epsilon > 0.13$ ;
3. two  $\text{PP}(F^{SB})$ , three  $\text{PP}(F^{SC})$ :  $\epsilon > 0.19$ .

All the remaining profiles have  $\epsilon > 0.25$  based on confirmed deviations.

Our conclusion from these observations is that  $\text{PP}(F^{SC})$  is a highly stable strategy within this strategic environment, and likely uniquely so. Of course, only limited inference can be drawn from even an extensive analysis of only one particular distribution of preferences, so we now consider other environments.

### 6.3 Self-Confirming Prediction in Other Environments

To test whether the strong performance of  $\text{PP}(F^{SC})$  generalizes across other SAA games, we undertook smaller versions of this analysis on variations of the model above. We explored 17 additional instances of the market-based scheduling problem: eight with the uniform (U), eight with the exponential (E) preference models (3–8 agents, 3–7 goods), and one with fixed preferences, corresponding to the counterexample model of Table 1. For each we derived self-confirming price distributions (failing in the last case, of course), as reported in Section 5.3.2. We also derived price vectors and distributions for the other prediction-based strategies. We ran between two and ten million games per profile in all of these environments.

For the non-symmetric game with fixed preferences, we evaluated all 53 profiles with at least one agent playing  $\text{PP}(F^{SC})$ .

For eleven of the symmetric games (eight U and three E models), we started by evaluating 27 profiles: one with all  $PP(F^{SC})$ , and for each of 26 other strategies  $s$ , one profile with  $n - 1$   $PP(F^{SC})$  and one  $s$ . In eight of these games,  $PP(F^{SC})$  and  $PP(F^{SB})$  were among top three unilateral deviations from  $PP(F^{SC})$  in the all- $PP(F^{SC})$  profile. For each of the eleven games, we identified five (additional) top-ranking deviations from  $PP(F^{SC})$  and evaluated complete 7-cliques involving these five strategies,  $PP(F^{SC})$  and  $PP(F^{SB})$  in the respective environments (at least 340,000 samples per profile).

For the five additional E models, we evaluated all profiles over seven selected strategies.<sup>16</sup>

Our results for U and E models are summarized in Table 2. For each case, we report the  $\epsilon$  that, for the estimated payoff matrix, renders all- $PP(F^{SC})$  an  $\epsilon$ -Nash equilibrium. The next two columns report sensitivity information about this figure, given its basis in payoffs estimated from samples. First, since our payoff matrix is estimated (and thus each payoff has a sampling variance), we calculate the expected value  $\bar{\epsilon}$  of  $\epsilon$  with respect to the empirical distributions of the estimated payoffs (assuming that the errors in our payoff estimates are independent, and using the sample variances as population variances). Thus, for example, the environment  $E(3, 5)$  has a pure Nash equilibrium of all- $PP(F^{SC})$  for the estimated payoff matrix, but taking into account sampling variation, on average that profile has an  $\epsilon$  of 0.005.

Under the same independence assumption, “ $\Pr(\epsilon = 0)$ ” represents the probability that all- $PP(F^{SC})$  is actually an equilibrium. Finally, for each empirical game with  $n \leq 6$  we also obtained a symmetric mixed-strategy Nash equilibrium using replicator dynamics.<sup>17</sup> The rightmost column reports the probability of playing  $PP(F^{SC})$  in the resulting mixture, to evaluate its significance when it does not constitute a pure-strategy equilibrium.

In 14 out of these 16 environments,  $PP(F^{SC})$  was verified to be an  $\epsilon$ -Nash equilibrium for  $\epsilon < 0.1$ . Twelve have  $\epsilon < 0.05$ , and in six of these (one U and

<sup>16</sup>For these models we did not incur the additional computational cost of evaluating all 27 profiles to select best deviations from  $PP(F^{SC})$ , which is a somewhat arbitrary procedure for selecting strategies for a clique in any case. Rather, we selected the seven candidate strategies based on regularities in the results from the other eleven games described above.

<sup>17</sup>By replicator dynamics we mean an iterative (evolutionary) algorithm for finding symmetric mixed-strategy equilibria in symmetric games. Our implementation is based on the replicator dynamics formalism introduced by Taylor and Jonker [1978] and Schuster and Sigmund [1983] and is described in detail in our earlier work [Reeves et al., 2005]. Though the method is not guaranteed to generate all Nash equilibria, we have found it particularly useful for finding sample Nash equilibria.

$\text{Env}(m, n)$	$\epsilon$ -gain from one-player deviation	$\bar{\epsilon}$ -gain adjusted for sampling error	$\text{Pr}(\epsilon = 0)$ : Probability of exact Nash equilibrium	Probability of play in rep. dyn. solution
$E(3, 3)$	0	0	1.00	1.00
$E(3, 5)$	0	.005	.600	.996
$E(3, 8)$	.031	.032	0	—
$E(5, 3)$	0	0	1.00	.999
$E(5, 5)$	0	.001	.900	.998
$E(5, 8)$	.029	.031	0	—
$E(7, 3)$	0	.007	.667	.992
$E(7, 6)$	.003	.007	.567	.549
$U(3, 3)$	.097	.099	0	.725
$U(3, 5)$	0	0	1.00	1.00
$U(3, 8)$	.017	.016	0	—
$U(5, 3)$	.103	.103	0	.809
$U(5, 8)$	.047	.048	0	—
$U(7, 3)$	.058	.060	0	.942
$U(7, 6)$	.018	.018	0	.929
$U(7, 8)$	.133	.132	0	—

Table 2: Evaluations of all-PP( $F^{SC}$ ) profile for U and E models.

five E) it was an exact equilibrium. The two worst environments were  $U(5, 3)$  and  $U(7, 8)$ . In the last case, expected payoff for all-PP( $F^{SC}$ ) was 2.67, so  $\epsilon$  represents about 5% of the value. For no other case did it reach 2%. Moreover, the results are quite insensitive to statistical variation. The  $\bar{\epsilon}$  values never exceed  $\epsilon$  by much, and in every environment for which we produced an equilibrium with replicator dynamics, PP( $F^{SC}$ ) appears in this symmetric mixed-strategy profile with substantial if not overwhelming probability.

Overall, we regard this as favorable evidence for the PP( $F^{SC}$ ) strategy across the range of market-based scheduling environments. Not surprisingly, the environment with fixed preferences is an entirely different story. Recall that in this case the iterative procedure failed to find a self-confirming price distribution. The distribution it settled on was quite inaccurate, and the trading strategy based on this performed poorly—generally obtaining negative payoffs regardless of other strategies. Since one of the available strategies simply does not trade, PP( $F^{SC}$ ) is clearly not a best-response player in this environment.

## 7 Strategies for Environments with Substitutes

In the previous sections we focused on the exposure problem when there are complementarities in preferences. We found that strategies based on price prediction can be quite effective in mitigating the problem. In this section we extend our analysis of bidding strategies to the case of substitutable goods. The strategic challenge in this environment is bidding when there are significant own price effects: bidding below willingness-to-pay for the marginal unit may lower the price sufficiently on inframarginal units to be a profitable strategy [Ausubel and Cramton, 2002]. We now expand the space of bidding strategies we evaluate to include simple demand-reduction strategies as well as a sophisticated approach to predicting own price effects inspired by the success of self-confirming price prediction for environments with complementarities. In the environment with substitutes we study, we find that the simple demand-reduction strategies clearly outperform this price predictor.

To analyze bidding strategies in an SAA game with substitutes, we assume that each auction sells one unit of a homogeneous indivisible good, and the bidders' marginal value for units of this good is weakly decreasing. We implemented such preferences by randomly drawing marginal values  $v_k$  for the  $k$ th good from  $U[0, v_{k-1}]$ , with  $v_0 = V$  a uniform upper bound on the marginal value of one unit.

In homogeneous-good environments bidders derive the same value from any

bundle of  $q$  goods regardless of their labels. The definitions of strategies in this section rely on this assumption, though it would not be difficult to generalize their approaches to apply to environments with a more general type of substitutability. The assumption of homogeneous goods is convenient for computational implementation and analysis, however, we believe that it is not essential to our main results.

## 7.1 Demand-Reduction Strategy

Consider an SAA game with  $m$  auctions, each selling one unit of an identical (homogeneous) good. If all agents follow SB, the outcome is that the bidders for the  $m$  most highly valued units win them, at a uniform price equal to the value of the most highly valued losing unit (possibly plus the bid increment). This is virtually equivalent to truth-telling in an  $m + 1$ st sealed-bid uniform-price auction. Like the truth-telling/sealed-bid case, the all-play-SB outcome is efficient (modulo the bid increment), but it is not an equilibrium. In fact, efficient equilibria in the  $m + 1$ st sealed-bid uniform-price auction do not exist [Ausubel and Cramton, 2002]. To motivate a possibly better strategy, consider the intuition for the non-existence of an efficient equilibrium: if a bidder has a positive probability of influencing price in a situation in which the bidder wins a positive quantity, then the bidder has an incentive to shade her bid in a sealed-bid uniform-price auction. Bid-shading leads to inefficient outcomes. This intuition and the failure of SB motivates considering strategies that suppress demand.<sup>18</sup>

We introduce a relatively simple demand-reduction strategy, DR. Let us modify SB by introducing a parameter  $\kappa \in [0, V]$  defining the degree of the agent's demand reduction. An agent playing strategy  $DR(\kappa)$  bids the ask price on the  $l$ th cheapest good as long as it is not winning that good, and its marginal surplus is at least  $\kappa(l - 1)$ . In other words, the agent considers the goods in order of price, adding the  $l$ th good to its bundle until the marginal value  $v_l$  drops below the ask price plus  $\kappa(l - 1)$ . The DR strategy family is a simple way of capturing the intuitions of the demand-reduction literature: bidders should shade their bids, and the amount of shading increases with the number of winning goods [Ausubel and

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<sup>18</sup>Note that the sunk-awareness modification of SB we introduced in Section 3.2 to address the exposure problem leads to overbidding, as opposed to bid-shading, in this environment. Using the terminology of Definition 1, the perceived-price vector of a sunk-aware strategy is equal to or below the myopic perceived-price vector used by SB, which results in more aggressive bidding. The perceived price of the demand-reduction strategy we introduce in this section is always at least as high as the myopic perceived-price vector.

Cramton, 2002].

Formally, define  $\text{DR}(\kappa)$ 's perceived price of the good with the  $l$ th lowest myopically perceived price (defined in Section 3):

$$\rho_l(\mathbf{B}) \equiv \begin{cases} \beta_l + \kappa(l - 1) & \text{if winning the good} \\ \beta_l + 1 + \kappa(l - 1) & \text{otherwise,} \end{cases} \quad (8)$$

where  $\beta$  is the vector of current bid prices. Agent  $\text{DR}(\kappa)$  plays the perceived-price bidding strategy using this  $\rho(\mathbf{B})$ . Note that  $\rho(\mathbf{B})$  as defined by (8) assumes that the goods are indistinguishable. We use the subscript  $l$  instead of  $i$  to emphasize that each good is labeled by its myopic price rank order rather than by the auction selling it.

## 7.2 Predicting Own Price Effects

The ability of a single agent to affect final prices is strategically central when goods are substitutes. Therefore, the focus of price prediction in the substitutes case is to model this relationship. Specifically, for the homogeneous-good environment, price predictions take the form of a mapping from purchase sizes (i.e., the agent's chosen demand) to final prices. The main role of this prediction is to guide the agent as to when it is beneficial to refrain from bidding on potentially valuable goods.

The assumption that final prices depend on the number of goods the agent is trying to win implies that the agent's prediction of the final price of good  $i$  can no longer be represented by a scalar. Let  $\pi_{iq}(\mathbf{B})$  be the predicted final price of good  $i$  given that the agent tries to win  $q$  goods and its information state at the current round is  $\mathbf{B}$ . We can think of the agent's *predicted own-effect prices* as an  $m \times m$  matrix, in which the rows are auction labels and the columns are the intended purchase sizes. We define an updating rule for  $\pi_{iq}$ ,  $i, q \in \{1, \dots, m\}$ , similar to the point price-prediction rule described in Section 4.1. The current price prediction for good  $i$  when the agent plans to bid on  $q$  goods is the maximum of the initial prediction and the myopically perceived price:

$$\pi_{iq}(\mathbf{B}) \equiv \begin{cases} \max(\pi_{iq}(\emptyset), \beta_i) & \text{if winning good } i \\ \max(\pi_{iq}(\emptyset), \beta_i + 1) & \text{otherwise.} \end{cases} \quad (9)$$

There is no apparent reason why an agent should believe that the final price of a homogeneous good on one auction will be higher than the price on another

auction. Therefore, we construct the initial price prediction to be equal across auctions:  $\pi_{iq}(\emptyset) = \pi_{jq}(\emptyset)$  for all  $i$  and  $j$  for all purchase sizes  $q$ . In other words, the elements in a column are identical in the agent's initial prediction matrix. We label the initial prediction matrix of predicted own-effect prices by  $\pi^x$ , in which the subscript  $x$  labels particular initial predictions.

In the homogeneous-good environment, agents are indifferent between item subsets of equal sizes. Thus, in our strategy, the agent uses price prediction to determine the number  $q^*$  of units to buy, but not to identify specific auctions in which to participate in the current round. Formally,

$$q^* = \arg \max_q \max_{|Y|=q} \sigma(Y, \pi_{.q}(\mathbf{B})),$$

where  $\sigma(Y, \mathbf{p})$  is the agent's surplus for goods  $Y$  defined by Equation (1), and  $|Y|$  refers to the number of goods in set  $Y$ .

Given  $q^*$ , the choice of goods  $X^*$  on which to actually bid is based on the current myopically perceived prices,  $\rho(\mathbf{B})$  as defined by Equation (2). Using myopically perceived prices ensures that the agent never regrets the composition of its bid set (conditional on size) even if its predicted own-effect prices are wrong.

$$X^* = \arg \max_{|X|=q^*} \sigma(X, \rho(\mathbf{B}))$$

The agent breaks ties as in Definition 1. Given  $X^*$ , the agent bids  $b_i = \beta_i + 1$  (the ask price) for the  $i \in X^*$  that it is not already winning. We call this strategy family the *own-effect price predictor* (OEPP) and denote a specific strategy in this family by  $\text{OEPP}(\pi^x)$ .

Similar to the point price predictor defined for complementary goods, the OEPP family includes SB as a special case when the predicted own-effect prices are a matrix of zeros:  $\text{SB} = \text{OEPP}(0)$ . As mentioned in Section 7.1, if all players follow SB, the allocation is efficient. Perceived prices based on an own-effect price matrix with positive elements are weakly higher than the myopic perceived prices SB uses. Therefore, an OEPP agent using positive predictions tends to bid on fewer items than is efficient given the others' bids, and never bids on more goods than SB would.

### 7.3 Self-Confirming Own-Effect Prices

We define the concept of self-confirming own-effect price prediction similarly to self-confirming point price prediction for complementary environments.

**Definition 5 (Self-Confirming Own-Effect Prices)** *Let  $\Gamma$  be an instance of an SAA game with homogeneous goods. Matrix  $\pi$  is a self-confirming own-effect price matrix for  $\Gamma$ , if for all  $i, q \in \{1, \dots, m\}$ ,  $\pi_{iq}(\emptyset)$  is equal to the expectation (with respect to the type distribution) of the final price when one agent tries to win  $q$  goods and all the other agents follow OEPP( $\pi$ ).*

In other words, self-confirming own-effect prices satisfy the condition that if one of the agents bids to win  $q$  goods and the other agents “exploit” their own-effect price predictions, that prediction on average *is correct* for all  $q$ . We denote the self-confirming own-effect price matrix by  $\pi^{SC}$  and the self-confirming own-effect price-prediction strategy by OEPP( $\pi^{SC}$ ).

To find approximate self-confirming own-effect prices, we follow an iterative procedure similar to that described in Section 5.3. First, we initialize the own-effect predictors with some own-effect price matrix (e.g., all zero) and, sampling from the homogeneous-good type distribution, run many SAA game instances with a profile in which one agent (the *explorer*) ignores its preferences and tries to win a single good, while the others follow OEPP. When average prices obtained by these agents are determined, we replace the first column in the own-effect price matrix with a column vector with all elements equal to the average price, reset the explorer to win two goods and repeat. After the second batch of simulations, we replace all elements in the second column of the own-effect matrix with the average price and increase the explorer’s target number of goods by one. We repeat the process, recycling back to a single unit after the exploration target reaches  $m$ . When this process reaches a fixed point, we have the matrix of self-confirming own-effect prices,  $\pi^{SC}$ . We have not investigated whether a fixed point necessarily exists in homogeneous-good environments, but the price predictions converged in this environment within 30 iterations in all of our experiments (see Figure 4).

## 7.4 Empirical Game Analysis

We perform analyses similar to, but less extensive than, those reported in Section 6. We analyzed the  $m = n = 5$  environment with uniform preferences introduced at the beginning of Section 7. We set the upper bound  $V$  to 127. In Figure 5 we display the agents’ average valuations as a function of the number of goods. As before, our goal is to evaluate the performance of a self-confirming price-prediction strategy, OEPP( $\pi^{SC}$ ) in this instance. Since the literature predicts that agents suppress demand in equilibrium, we include many instances of our demand-reduction strategy family. We analyzed 51 strategies: SB, 47 DR( $\kappa$ )

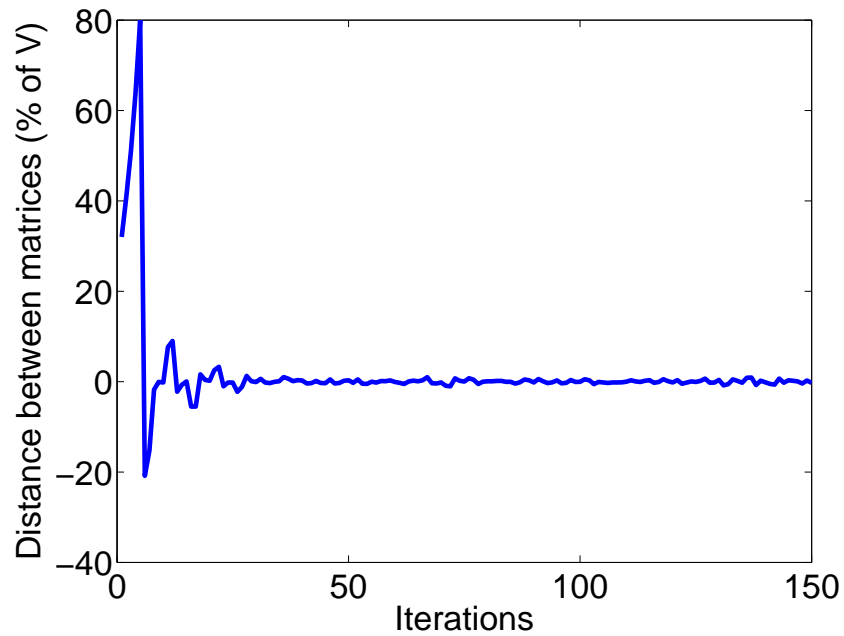


Figure 4: Convergence to a self-confirming own-effect price matrix, starting with an initial prediction that all prices would be zero regardless of the size of the agent's purchase. The prices at each iteration are determined by 10 thousand simulated games. The graph plots the distance between the own-effect prices in consecutive iterations. We define distance between matrices as the maximum over pointwise distances, measured as a percentage of the upper bound on the marginal value,  $V$ , of a single unit of the good. The bound  $V$  equals 127 in all of our SAA games with substitutes.

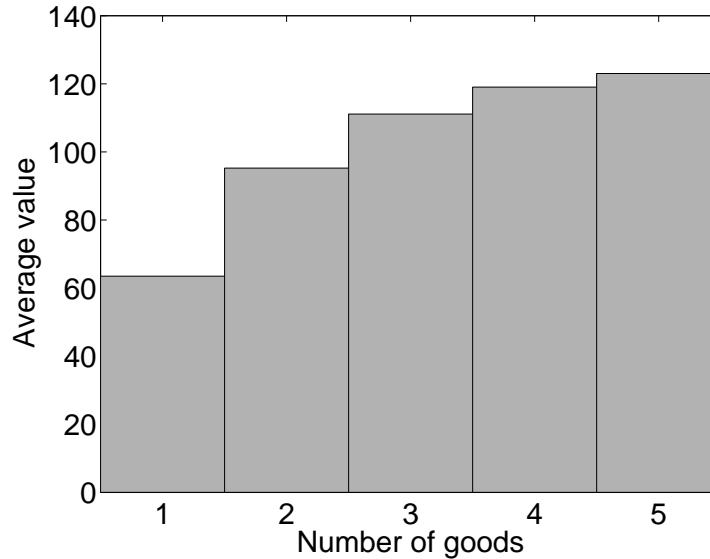


Figure 5: Preference distribution in the homogeneous-good environment.

with  $1 \leq \kappa \leq 120$ , one sunk-aware strategy with parameter  $k = 0.5$ , a self-confirming own-effect price predictor  $\text{OEPP}(\pi^{SC})$ , and the baseline distribution predictor  $\text{PP}(F^{SB})$  (defined in Section 5).

We estimated payoffs for 16542 strategy profiles (out of 3.48 million possible), based on an average of 986 thousand samples per profile. Some profiles are simulated for as few as 40 thousand samples; near-Nash-equilibrium profiles were simulated for up to 205 million game instances per profile. Despite the high-quality information  $\text{OEPP}(\pi^{SC})$  employs about own effect on final prices, the strategy's use of this information did not provide any advantage over the simpler information-free demand-reduction agents. In the majority of profile settings where it was tested,  $\text{OEPP}(\pi^{SC})$  can be refuted with a  $\text{DR}(\kappa)$  strategy. Indeed, for 96% of the 16542 profiles analyzed, we found the best deviation in our data set to be an instance of  $\text{DR}(\kappa)$  with  $10 \leq \kappa \leq 22$ . For 108 profiles our data set includes estimated payoffs for all deviations from all strategies. The best deviations for these profiles are always an instance of  $\text{DR}(\kappa)$  with  $16 \leq \kappa \leq 19$ .

We provide more evidence in Figure 6 by displaying the number of times a strategy was a best deviation (dark bars) relative to the number of estimated profiles in which that strategy appeared (light bars). The latter is proportional to the approximate number of opportunities for that strategy to be a best deviation

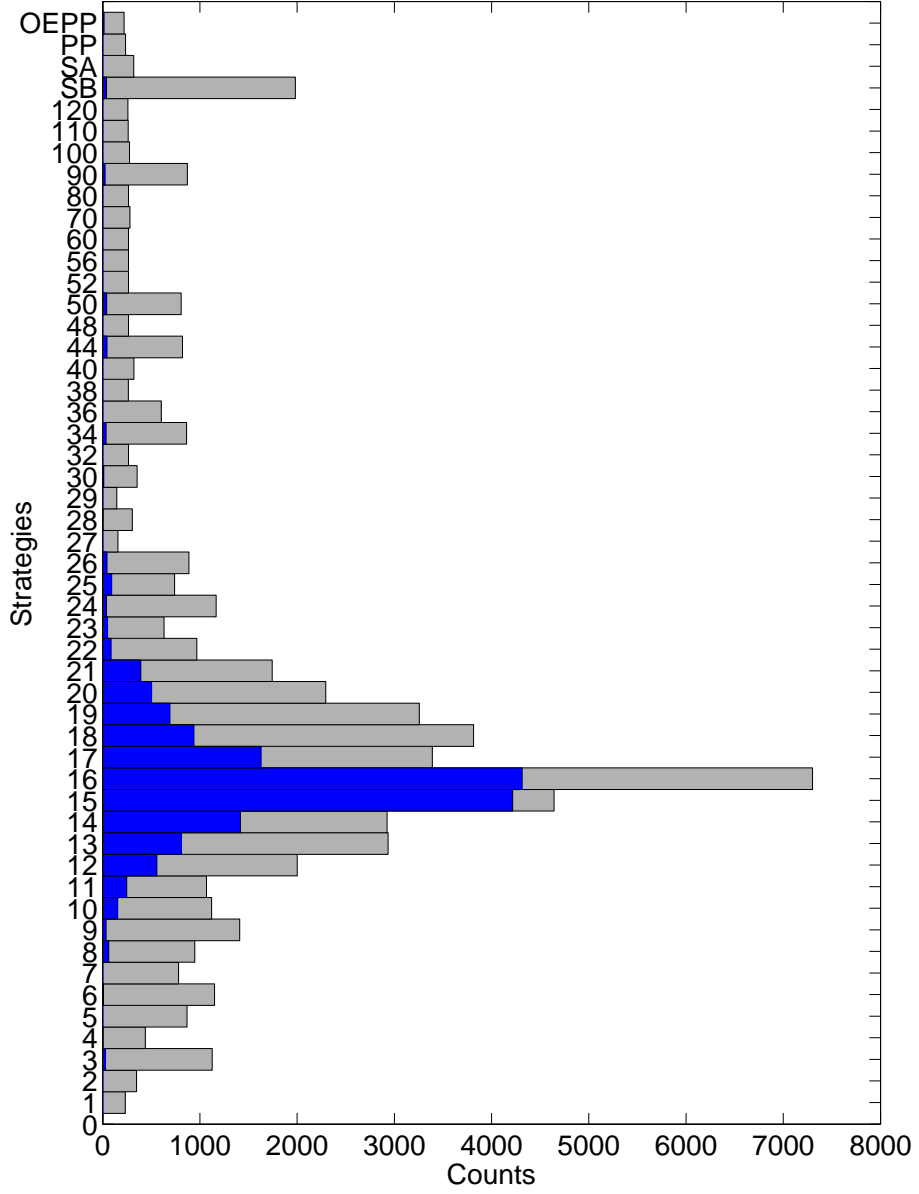


Figure 6: Distribution of best deviations. The light bars reflect the number of estimated profiles in which the corresponding strategy appeared. The dark bars reflect how many times the strategy in fact *was* a best deviation. We index demand-reduction strategies  $DR(\kappa)$  by their corresponding  $\kappa$ -values. OEPP refers to  $OEPP(\pi^{SC})$ , PP to  $PP(F^{SB})$ , and SA refers to the sunk-aware strategy with  $k = 0.5$ .

from some other profile. The dark bars reflect the preponderance of situations in which agents prefer moving toward a  $DR(\kappa)$  strategy with  $\kappa$  near 15. The light bars document our decision, as this evidence was emerging, to focus our finite computational resources on estimating regions of the payoff matrix most important for (near-)equilibrium play.

We found only 14 profiles for which the highest gain can be obtained by deviating to  $OEPP(\pi^{SC})$ . This is 0.085% of all estimated profiles and 6.36% of all profiles containing at least one  $OEPP(\pi^{SC})$  player. We found 40 profiles for which SB is the best deviation. The sunk-aware and  $PP(F^{SB})$  strategies are never the most attractive deviations in our data.

We found many pure-strategy asymmetric  $\epsilon$ -Nash equilibria in this environment. Those with the lowest  $\epsilon$  are profiles of  $DR(\kappa)$  with  $14 \leq \kappa \leq 17$ . To give a sense of the magnitude of demand (bid) suppression, these  $\kappa$ s correspond to 33–40% of the average final unit price if all players follow SB. In Table 3 we present all  $\epsilon$ -Nash equilibria for which  $\epsilon \leq 0.015$ <sup>19</sup> and two of our benchmark profiles: all-SB and all- $OEPP(\pi^{SC})$  (for which the  $\epsilon$  is rather large). The probability that the profile is an exact Nash equilibrium was estimated empirically as described in Section 6.3. The profiles are listed in the order of increasing  $\epsilon$ . We have estimated payoffs of all unilateral deviations from the strategies in the near-Nash-equilibrium profiles to all of the other 50 pure strategies. These  $\epsilon$ -equilibria all consist of  $DR(\kappa)$  with  $\kappa$ s in a narrow range; the best deviations are to nearby  $\kappa$ s (column 2). If all agents follow  $OEPP(\pi^{SC})$ , a single agent can improve her payoff by at least 2.86 (5.5% of the average payoff) by deviating to  $DR(24)$ .

As expected, equilibrium outcomes are inefficient in this environment. However, the efficiency loss is small: all-16, the symmetric profile with the smallest  $\epsilon$ , achieves 98.55% efficiency. We present efficiency results for a few symmetric near-Nash-equilibrium profiles and our benchmark profiles in Table 4.

Our results suggest that  $OEPP(\pi^{SC})$  is a weak competitor against  $DR(\kappa)$ . The weakness of  $OEPP(\pi^{SC})$  may lie in its failure to adjust its bidding to its opponents' behavior: having good information does not guarantee strategic advantage. We observe that  $OEPP(\pi^{SC})$  bids like an aggressive demand-reduction agent. As a consequence, it earns high profits when playing against other predictors: essentially, in a profile of all- $OEPP$ , players are tacitly colluding to reduce demand and thus prices. Payoffs would be higher if all agents could commit to this

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<sup>19</sup>For reference, the payoffs range from 30 to 69 in our empirical payoff matrix. Thus, the near-equilibrium profiles in Table 3 are quite close to equilibria: the  $\epsilon$  of 0.015 constitutes at most 0.05% of the payoff.

$\epsilon$ -Nash-equilibrium profile	Best deviation	$\epsilon$ -gain from one-player deviation	$\bar{\epsilon}$ -gain adjusted for sampling error	Probability the profile is exact Nash equilibrium
15 15 16 16 16	15 $\rightarrow$ 16	0	0.001	0.58
all-16	16 $\rightarrow$ 15	0.001	0.004	0.25
15 16 16 16 16	16 $\rightarrow$ 15	0.001	0.006	0.14
15 15 15 16 16	15 $\rightarrow$ 16	0.004	0.005	0.11
14 16 16 16 16	16 $\rightarrow$ 15	0.004	0.008	0.02
15 15 15 15 16	15 $\rightarrow$ 16	0.005	0.009	0
15 16 16 16 17	15 $\rightarrow$ 16	0.006	0.007	0.11
14 14 15 15 16	14 $\rightarrow$ 15	0.006	0.008	0.02
14 14 14 16 16	14 $\rightarrow$ 15	0.007	0.008	0.09
14 15 15 16 16	14 $\rightarrow$ 16	0.008	0.009	0.02
15 15 17 17 17	17 $\rightarrow$ 16	0.008	0.012	0
14 14 15 15 15	14 $\rightarrow$ 15	0.009	0.008	0.07
15 15 15 17 17	17 $\rightarrow$ 15	0.009	0.010	0.02
14 14 14 15 15	14 $\rightarrow$ 15	0.010	0.010	0.05
14 15 15 15 16	16 $\rightarrow$ 15	0.011	0.010	0.02
16 16 16 16 17	17 $\rightarrow$ 15	0.011	0.010	0.02
all-15	15 $\rightarrow$ 16	0.012	0.012	0.04
15 15 16 17 17	17 $\rightarrow$ 16	0.012	0.012	0.01
15 16 16 17 17	17 $\rightarrow$ 16	0.012	0.013	0
14 14 16 16 16	14 $\rightarrow$ 15	0.012	0.013	0
15 17 17 17 17	15 $\rightarrow$ 16	0.012	0.014	0
14 14 14 15 16	16 $\rightarrow$ 15	0.013	0.015	0
14 15 16 16 16	14 $\rightarrow$ 15	0.013	0.014	0.01
15 15 16 16 17	17 $\rightarrow$ 16	0.013	0.013	0
14 14 15 16 16	14 $\rightarrow$ 15	0.014	0.014	0
all-17	17 $\rightarrow$ 16	0.014	0.015	0
15 16 17 17 17	15 $\rightarrow$ 16	0.015	0.015	0
16 17 17 17 17	17 $\rightarrow$ 16	0.015	0.015	0
all-SB	SB $\rightarrow$ 14	1.450	1.469	0
all-OEPP	OEPP $\rightarrow$ 24	2.857	2.905	0

Table 3:  $\epsilon$ -Nash equilibria for the substitutes environment. The profiles are listed in order of increasing  $\epsilon$ .

$\epsilon$ -Nash-equilibrium profile	Best deviation	$\epsilon$ -gain from one-player deviation	Average payoff	Efficiency (%)
all-SB	SB $\rightarrow$ 14	1.450	34.266	100
all-14	14 $\rightarrow$ 15	0.020	44.665	98.82
all-15	15 $\rightarrow$ 16	0.012	45.230	98.69
all-16	16 $\rightarrow$ 15	0.001	45.773	98.55
all-17	17 $\rightarrow$ 16	0.014	46.307	98.40
all-18	18 $\rightarrow$ 17	0.035	46.810	98.26
all-OEPP	OEPP $\rightarrow$ 24	2.857	52.063	93.75

Table 4: Efficiency of some symmetric  $\epsilon$ -Nash equilibria in the substitutes environment. The profiles are listed in order of decreasing efficiency.

behavior. However, when collusion is unenforceable, the usual motive to deviate unilaterally is strong.

## 8 Discussion

Our investigation of bidding strategies for simultaneous auctions leads to qualitatively different conclusions for environments characterized by complementary and substitutable preferences. For the case of complements, we find strong support for a bidding strategy based on probabilistic price prediction, with *self-confirming predictions* derived through an equilibration process. Like other decision-theoretic approaches to bidding [Greenwald and Boyan, 2004], this strategy tackles the exposure problem head-on, by explicitly weighing the risks and benefits of placing bids on alternative bundles, or no bundle at all. The fact that the predictions are self-confirming suggests that this cost-benefit analysis will be accurate when other agents are following the same strategy.

Given the analytic and computational intractability of the SAA game, we evaluated our self-confirming probabilistic price-prediction strategy,  $PP(F^{SC})$ , using an empirical game-theoretic methodology. We explored a restricted strategy space including  $PP(F^{SC})$  along with a range of candidate strategies identified in prior work. Despite the infeasibility of exhaustively exploring the profile spaces, our analyses support several game-theoretic conclusions. The results provide favorable evidence for our new strategy—very strong evidence in one environment we

investigated intensely, and somewhat less categorical evidence for a range of variant environments.

For the case of substitutes, the driving strategic issue is demand reduction rather than exposure risk, and thus it is necessary to predict own price effects as well as exogenous price levels. We defined a bidding strategy, OEPP, based on such predictions, and a concept of self-confirming prices analogous to the approach that proved so successful in complementary environments. In this domain, however, the strategy OEPP( $\pi^{SC}$ ) based on explicit self-confirming predictions did not fare well, proving in our empirical experiments significantly inferior to an approach based on simple across-the-board demand reduction.

There are several possible explanations for the relative lack of success of explicit price prediction in substitutes environments. One is that the particular OEPP method we investigated measures own price effects under unrealistic assumptions. Specifically, the strategy predicts the effect of selecting a demand level (number of goods to go for), and sticking with that choice thereafter. In actuality, the agent can and does reconsider its choice at each round conditional on the current auction information. This myopic assumption about the agent's own behavior would tend to overestimate the effect of its immediate decision about demand at the current prices, and thus cause it to reduce demand more aggressively than warranted.

The simple demand-reduction strategy, DR( $\kappa$ ), can pursue an appropriate degree of demand reduction in a particular environment by tuning the free parameter  $\kappa$ . This approach was successful in our experimental environment, but would presumably need to be retuned for a different configuration of goods and preferences. It remains for future work to identify a general approach for deriving robust demand-reduction strategies directly from specification of preference distributions.

Returning to environments with complementarities, our results establish the self-confirming price-prediction strategy as the leading contender for dealing broadly with the exposure problem. If agents make optimal decisions with respect to prices that turn out to be right, there may not be room for performing a lot better. On the other hand, there are certainly areas where improvement should be possible, for example:

- incorporating price dependencies (but with reasonable computational effort);
- more graceful handling of instances when self-confirming price distributions do not exist;

- more sophisticated prediction updates given price quotes, including possible incorporation of history; and,
- timing of bids: trading off the risk of premature quiescence with the cost of pushing prices up.

Dealing with combinations of complementarity and substitutability, by combining considerations of exposure and demand reduction, is perhaps the most obvious direction for extending the scope of bidding-strategy ideas developed here.

Finally, an indirect contribution of this work is to demonstrate an empirical methodology for game-theoretic analysis when strategy determination is analytically intractable [MacKie-Mason and Wellman, 2005, Wellman, 2006]. We find that even when strategy spaces are enormous, much can be learned by empirically converting an extensive-form game into a normal form in expected payoffs for strategy choices, combined with thoughtful selection of payoff-matrix regions to estimate, and carefully targeted analyses of results.

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