IFN Working Paper No. 882, 2011

Sealed Bid Auctions vs. Ascending Bid Auctions: An Experimental Study

Christer Andersson, Ola Andersson and Tommy Andersson

Research Institute of Industrial Economics
P.O. Box 55665
SE-102 15 Stockholm, Sweden
info@ifn.se
www.ifn.se

Sealed Bid Auctions vs. Ascending Bid Auctions: An Experimental Study *

Christer Andersson[†], Ola Andersson[‡] and Tommy Andersson[§]

September 19, 2011

Abstract

This paper considers the sealed bid and ascending auction, which both identifies the minimum Walrasian equilibrium prices and where truthful preference revelation constitutes an equilibrium. Even though these auction formats share many theoretical properties, there are behavioral aspects that are not easily captured. To explore this issue in more detail, this paper experimentally investigates what role the design of the auction format has for its outcome. The results suggest that the sealed bid mechanism performs weakly better in all of investigated measures (consistent reporting, efficiency etc.). In addition, we find that the performance of the ascending auction is increasing over time, whereas the sealed bid auction shows no such tendency.

JEL Classification: C91; D44.
Key Words: Auctions; Non-manipulability; Efficiency; Experiments.

1 Introduction

Auctions are common practice, when allocating and pricing scarce resources, on a variety of markets. Examples include the markets for spectrum licences, debts, emissions and commodities (e.g. fish, wool, timber etc.). The insight that the Vickrey–Clarke–Groves (VCG) sealed bid auction generates an ex post efficient outcome that in addition provides bidders with the incentives to truthfully reveal their preferences has motivated a substantial amount of research.

*Financial support from the Jan Wallander and Tom Hedelius Foundation is gratefully acknowledged.
[†]Department of Economics, Lund University, P.O. Box 7082, SE-220 07 Lund, Sweden.
[‡]Research Institute of Industrial Economics (IFN), P.O. Box 55665, SE-102 15 Stockholm Sweden.
[§]Department of Economics, Lund University, P.O. Box 7082, SE-220 07 Lund, Sweden.

In particular, Demange and Gale (1985) and Leonard (1983) consider a VCG multi-item auction that identifies the minimum Walrasian equilibrium price vector and use it as a mechanism to allocate the items among the bidders. In such auctions, it is a weakly dominant strategy for the bidders to report their true valuations given that they wish to acquire at most one item (unit–demand bidders). A competing auction format is the ascending bid auction, where the multi-item auction from Demange et al. (1986) is a prominent example. Under this format the unit–demand bidders gradually reveal information about their demand sets until the mechanism converges. Also this mechanism identifies the minimum Walrasian equilibrium price vector and truthful bidding is an ex post equilibrium given a set of simple rules that guarantee a specific structure on the bids (see de Vries et al., 2007; Mishra and Parkes, 2007; and the more detailed discussion in Section 2.2).

Because the multi-item auctions in both the sealed bid and the ascending format identify the minimum Walrasian equilibrium price vector and have the property that truthful bidding constitutes an equilibrium they are theoretically equivalent in terms of predictions. However, there are many behavioral aspects of these two formats that are not easily captured. In particular, they differ in terms of e.g. how much information that is revealed about the bidders' valuations, how complex the format is and how information about other bidders' behavior is transmitted (see Cramton, 1998 for a discussion). Ex ante it is not evident if and how these aspects affect the outcome of the auction formats. Hence, it is natural to take the theory to data. Because we are not aware of any "real world" situation where the two auction formats are conducted in comparable contexts, the evaluation is best done by way of an economic experiment. Moreover, the experimental method enables us to have a more strict control over valuations, which is pivotal for the theoretical predictions.

To investigate what role the design of the auction format has for its outcome, we conducted an experiment with the sealed bid (Demange and Gale, 1985; Leonard, 1983) and the ascending (Demange et al., 1986) auction format as treatments. Overall we find that the sealed bid mechanism performs weakly better in the measures reported here (i.e., consistent reporting, efficiency and assignment of items). The results also confirm previous findings that subjects typically report non-truthful.[1] Moreover, for all investigated measures, there is a significantly positive time trend in the ascending treatment but not in the sealed bid treatment.

The remaining part of the paper is organized as follows. Section 2 introduces the two auction formats. Section 3 describes the experimental design and implementation. Section 4 contains the main results. Section 5 concludes the paper.

[1] See e.g. Attiyeh et al. (2000), Harstad (2000), Kagel et al. (1987), Kawagoe and Mori (2001) and Kagel and Levin (1993) for similar results.

2 Auction Formats

Let the set of bidders and items be denoted by $B = \{1, ..., n\}$ and $I = \{1, ..., m\}$, respectively. Each item $i \in I$ has a price $p_i \geq 0$ where without loss of generality $p_i = 0$ represents the sellers' reservation price. The prices are gathered in the vector $p = (p_1, ..., p_m)$. The private value of item $i \in I$ to bidder $b \in B$ is represented by v_{bi}. Consequently, each bidder $b \in B$ is characterized by a vector of type $v_b = (v_{b1}, ..., v_{bm})$. There is also an unlimited number of "no items" (denoted by 0) whose prices and values always equal zero. The demand set for bidder $b \in B$ at prices p is defined by:

$$D_b(p) = \{i \in I \cup \{0\} : v_{bi} - p_i \geq v_{bj} - p_j \text{ for all } j \in I \cup \{0\}\}.$$

A price vector p is said to be a Walrasian equilibrium price vector if there is an assignment $x : B \mapsto I$ such that $x_b \in D_b(p)$ for all $b \in B$ and $x_b \neq x_{b'}$ if $b' \neq b$ and $\{x_b, x_{b'}\} \subseteq I$, i.e., each bidder is assigned an item from his demand set and each item different from the "no item" can be assigned to at most one bidder. The pair (p, x) is a Walrasian equilibrium if p is a Walrasian equilibrium price vector and if $x_b \neq i$ for all $b \in B$ then $p_i = 0$, i.e., if an item is not assigned to any bidder, then its price must equal reservation price. As demonstrated by Shapley and Shubik (1972) the set of Walrasian equilibrium price vectors is non-empty and forms a complete lattice. Thus, the existence of a unique minimum Walrasian equilibrium price vector $p^{\min}$ is guaranteed.

2.1 The Sealed Bid Format

In the sealed bid mechanism (Demange and Gale, 1985; Leonard, 1986) each bidder $b \in B$ reports his values of the items $\hat{v}_b$ to the auctioneer. This report may be truthful or not but based on it the auctioneer identifies the minimum Walrasian equilibrium price vector $\hat{p}^{\min}$ by solving a simple LP-problem. Given that $\hat{p}^{\min}$ is used as a mechanism to allocate the items among the bidders, the sealed bid auction has a (weakly) dominant strategy equilibrium where each bidder $b \in B$ reports $\hat{v}_b = v_b$. This results in an ex post efficient outcome in the sense that the sum $\sum_{b \in B} v_{bx_b}$ is maximized.

2.2 The Ascending Format

The ascending bid auction (Demange et al., 1986) differs from the sealed bid auction in the sense that bidders do not submit a report of type $\hat{v}_b$ as in the latter. Instead, bidders gradually reveal information about their demand sets, for given price vectors, until the ascending mechanism converges. To formalize the procedure, let the set of bidders demanding only items in the set $S \subseteq I$ at prices p be denoted by $C(S,p) = \{b \in B : D_b(p) \subseteq S\}$. A set of items S is said to be overdemanded if the number of bidders demanding only items in this set is greater than the number of items in the set, i.e., if $|S| < |C(S,p)|$. An overdemanded set with the property that none of its proper subsets is overdemanded is called a minimal overdemanded set.

The ascending mechanism can be described as follows. The auctioneer announces a price vector p. Each bidder then reports (truthful or not) his demand set $\hat{D}(p)$.[2] If there is no over demanded set of items, the mechanism terminates. Otherwise, prices are increased for an arbitrary minimal overdemanded set of items according to some rule.[3] The procedure is repeated until the family of overdemanded sets is empty. As demonstrated by Demange et al. (1986), this procedure will always identify an efficient minimum Walrasian price equilibria in a finite number of iterations given that reports are truthful in each iteration. In addition, truthful reports constitute an equilibrium given that bids are consistent with some activity rule[4] (Vries et al., 2007; Mishra and Parkes, 2007).

3 Experimental Design and Implementation

The experiment was conducted at Lund University in September 2010. We ran four separate sessions consisting either of a sealed bid- (S) or an ascending (A) multi-item auction treatment. In total 117 subjects participated (60 in treatment S and 57 in treatment A). The subjects were students at the introductory or intermediate level in Economics at Lund University. Instructions were given both written and aloud to the subjects at the beginning of the experiment.[5] We also conducted a test period in order for the subjects to familiarize with the software.

At the beginning of the session, subjects were randomly assigned to a bidder type (1, 2 or 3) and a group consisting of three subjects of different type. Each three-person group was fixed in all 10 periods of the session. All subjects knew that they

[2] If this set contains more than one item, the bidder is indifferent between all reported items.

[3] Such a rule may be to increase the price of all items in the selected minimal overdemanded set S by one unit (Demange et al., 1986) or to ask the agents that only demand items from the set S to report the minimum price increase that would make them indifferent to an item outside S (Andersson and Andersson, 2011). This paper adopts the latter rule.

[4] The meaning of an activity rule is that bidders not are allowed to submit conflicting reports across the iterations of the ascending procedure. For example, if bidder b reveals that $\hat{v}_{bi} - \hat{v}_{bi'} \geq \delta$ for some $\delta \in \mathbb{N}$ in iteration t, then it cannot be the case that the very same bidder reveals that $\hat{v}_{bi} - \hat{v}_{bi'} < \delta$ in some subsequent iteration $t + k$.

[5] A transcript of the instructions is available in Appendix B

were grouped with two other participants, but could not discern who they were.

The subjects were informed that they would participate in an auction over three items (denoted by 1, 2 and 3). In particular, they were given the information that if they were awarded item 1, 2 or 3, then (i) they have to pay a price and (ii) the item will automatically be resold at the end of the period at a predetermined price called the resale value. The resale values v_b of bidder type $b \in \{1, 2, 3\}$ for items $i \in \{1, 2, 3\}$ was given by:

$$\begin{bmatrix} v_1 \\ v_2 \\ v_3 \end{bmatrix} = \begin{bmatrix} v_{11} & v_{12} & v_{13} \\ v_{21} & v_{22} & v_{23} \\ v_{31} & v_{32} & v_{33} \end{bmatrix} = \begin{bmatrix} 20 & 20 & 100 \\ 20 & 60 & 100 \\ 40 & 60 & 80 \end{bmatrix} \tag{1}$$

The resale value of the "no item" was zero. Each subject knew his/her resale values but not the resale values of the other two participants. Truthful reports under both treatment S and A given (1) yields the assignment $(x_1, x_2, x_3) = (3, 2, 1)$ with corresponding minimum Walrasian equilibrium prices $(p_1, p_2, p_3) = (0, 20, 60)$, i.e., bidder type 1 is assigned item $x_1 = 3$ at price $p_3 = 60$ and so on.

The subjects in treatments S and A received the following information of how the mechanism worked:

> "The prices for items 1, 2 and 3 will be determined automatically by a computer program according to a predetermined rule which is based on the reports of all three members of the group."

As previously explained in Section 2, these reports was given by a vector of type $\hat{v}_b$ in treatment S and the reported demand sets in each iteration of the ascending mechanism under treatment A. Similarly, the only information given to the subjects regarding which item they will be assigned was the following treatment equivalent information:

> "Each group member will be awarded the item where the difference between the stated valuation and the calculated price is the highest." [Treatment S]

> "If each group member can be assigned an item from his/her reported demand set, the auction is terminated" [Treatment A]

The payoff in each period was given by the difference between the resale value of the item assigned to the subject and its price. If the subject was assigned "no item", the payoff was zero. At the end of the experiment, the accumulated payoffs were converted into Swedish kronor according to an exchange rate of 1 experimental currency unit = 0.5 SEK.[6] Subjects received a show-up fee of 50 SEK and the average earnings were 314 SEK. A session took approximately 45 minutes to conduct.

4 Results

We start by an analyzing the of subjects' reporting behavior.[7,8] Following Olson and Porter (1994) we define a measure of consistent reporting as follows: In the S treatment we say that a report is *consistent* if the order of $\hat{v}_b$ preserves the order of v_b for subject b. For example, if the subject has valuation profile 1 then we require that $\hat{v}_{13} > \hat{v}_{12} = \hat{v}_{11}$ for the report $\hat{v}$ to be consistent. In the A treatment we say that a report is *consistent* if $\hat{D}_b(p) = D_b(p)$ where $\hat{D}_b(p)$ and $D_b(p)$ are the reported and the true demand set for subject b at prices p, respectively. Subjects that report inconsistent and consistent are assigned the values 0 and 1, respectively, in the consistency measure. As a consequence, the average consistency measure for a sample of subjects always belongs to the closed interval $[0, 1]$.

Table 1: Mean values for the investigated measures.

	Consistency		Equilibria		Efficiency	
Period	A	S	A	S	A	S
1	0.19	0.53	0.11	0.60	0.69	0.96
2	0.18	0.48	0.26	0.45	0.81	0.94
3	0.33	0.57	0.37	0.65	0.86	0.95
4	0.39	0.63	0.32	0.60	0.89	0.95
5	0.35	0.58	0.42	0.45	0.90	0.93
6	0.37	0.60	0.42	0.25	0.91	0.85
7	0.33	0.48	0.42	0.45	0.89	0.93
8	0.40	0.55	0.47	0.50	0.92	0.94
9	0.41	0.53	0.37	0.45	0.92	0.93
10	0.37	0.57	0.53	0.55	0.94	0.95
All periods	0.33	0.55	0.37	0.50	0.87	0.93
Period 1–5	0.29	0.56	0.29	0.55	0.83	0.94
Period 6–10	0.38	0.55	0.44	0.44	0.91	0.92

The average consistency measures for the two treatments are reported in columns 2 and 3 of Table 1. A first observation is that the average consistency measure is

[6] At the time of experiment 1 SEK ≈ 0.11 EUR.

[7] In order to facilitate a comparison between treatments S and A we only analyze the final iteration in A.

[8] For the interested reader Table 5 in Appendix A reports the average prices by period and treatment for each item.

well below the equilibrium prediction (i.e. 1.00), which should not come as a surprise given the findings of previous experimental papers (see footnote 1). A second observation is that the S treatment has a higher degree of consistency in every period. To facilitate a statistical comparison between the two treatments the average consistency within each three-person group was calculated. In this way 39 independent observations (20 in treatment S and 19 in treatment A) were created. Using a two–sided Mann–Whitney test we find that there is a statistical difference between the treatments in overall mean consistency (p-value = 0.000). To examine the effects of experience the sample was divided into two categories: Subjects are defined to be *inexperienced* if they are in period 1–5 and *experienced* otherwise. Again the two–sided Mann–Whitney test reveals that there is a significant difference in consistency for inexperienced (p-value = 0.000) as well as for experienced (p-value = 0.002) subjects.

Even if the S treatment has a significantly higher degree of consistency it is evident by studying Table 1 that the gap between the treatments is smaller in later periods indicating that there is a possible positive time trend in the data for treatment A. To investigate this closer we estimated a linear random effects regression with the consistency measure as the independent variable and including a time variable as the dependent variable.[9] Interestingly, the regression estimates in Table 2 reveal that there is a positive time trend in the A treatment but not in the S treatment.

Table 2: Estimations on consistency

	Treatment A	Treatment S
Period	0.0198***	0.0008
	[0.0031]	[0.0078]
Constant	0.221***	0.549***
	[0.0283]	[0.0480]
Observations	570	600

Robust standard errors in brackets. *** p < 0.01, ** p < 0.05, * p < 0.1.

We next report the fraction of groups in a selected sample with an assignment of items according to the equilibrium prediction. This will also be a measure in the closed interval $[0, 1]$. By adopting the same statistical test as before we found that there is a significant difference between the two treatments when subjects are inexperienced (p-value = 0.011) but not when they are experienced (p-value = 0.954) or

[9]Since we are not interested in making forecasts we use linear regressions even though they might give predictions outside $[0, 1]$ interval. Corresponding probit estimations reveal the same patters as reported here.

overall (p-value = 0.126). Our next observation is that exactly as for the consistency measure, it is clear (from columns 4 and 5 of Table 1) that treatment S is closer to the theoretical prediction in the first periods whereas this gap is closed in later rounds. Thus, one can expect that there is a positive time trend not only for the consistency measure but also for the equilibrium measure. To investigate this in more detail we estimated a linear random effects regression using the group allocation dummy as the dependent variable and including a time variable as an independent variable. The regression output in Table 3 verifies the above suspicion that there is a strong positive time trend in the A treatment but not in the S treatment.

Table 3: Estimations on equilibrium outcomes

Treatment	A	S
Period	0.0198**	0.0024
	[0.0092]	[0.0091]
Constant	0.523***	0.707***
	[0.1020]	[0.0848]
Observations	190	200

Robust standard errors in brackets. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

It is also interesting to see how close, in terms of efficiency, each group was to the equilibrium prediction. In line with Olson and Porter (1994) we calculate an efficiency index for each three-person group as follows:

$$E = \frac{\sum_b \sum_i y_{bi} v_{bi}}{\sum_b \sum_i y^*_{bi} v_{bi}}, \tag{2}$$

where y_{bi} is an indicator variable taking the value 1 if subject b is assigned item i and zero otherwise, and y^*_{bi} is the indicator variable given true reports (i.e. $y^*_{13} = y^*_{22} = y^*_{31} = 1$ and $y^*_{bi} = 0$ for the remaining pairs (b, i)). Because the sum of valuations is maximized when reports are consistent (see Section 2) the denominator in (2) will always be weakly larger than the numerator. Hence, also this measure produces a number in the closed interval $[0, 1]$.

Columns 6 and 7 in Table 1 show the mean efficiency by period in the S and A treatment. The efficiency measure is quite similar across treatments, with only a slight advantage for the static mechanism in early periods. To facilitate a statistical analysis we adopt the two-sided Mann–Whitney test as in the above. The test demonstrates that there is a statistical advantage for the static mechanism when subjects are inexperienced (p-value = 0.000) but not experienced (p-value = 0.6907).

Overall there seems to be a advantage for the static mechanism (p-value = 0.001). To investigate if there is a positive time trend in treatment A also for this measure we adopt the the same methodology as for the equilibrium measure and estimate a random effects panel regression. The regression output in Table 4 reveals that there is a significant positive time trend in the A treatment but not in the S treatment.

Table 4: Efficiency estimations

Treatment	A	S
Period	0.0199***	-0.0018
	[0.0034]	[0.0016]
Constant	0.762***	0.941***
	[0.0340]	[0.0113]
Observations	190	200

Robust standard errors in brackets. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

5 Conclusion

In summary we find that the sealed bid mechanism dominates the ascending counterpart in all measures reported here. The difference between the two auction formats is more pronounced when subjects are inexperienced than when subjects are experienced. This latter finding is further strengthen by the presence of significant positive time trend in the ascending treatment measures. No time trend is not found in the sealed-bid treatment. It is therefore alluring to conclude that after a suitable number of periods, the ascending bid mechanism will dominate the sealed bid counterpart. One should however always be careful when extrapolating results and further experimental results are needed to validate this claim. In regards to the policy dimension it is risky to draw general conclusions from a single experiment and we are in general unwilling to do so. But we think that it is safe to say that if an auction is to be conducted just once, then the sealed bid mechanism is to prefer.

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A Additional Tables

This Appendix reports the mean prices by period and treatment (see Table 5). We also recall that the minimum Walrasian equilibrium prices in our experimental setting is given by the price vector $(p_1, p_2, p_3) = (0, 20, 60)$.

Table 5: Mean prices

	Price item 1		Price item 2		Price item 3	
Period	A	S	A	S	A	S
1	0.32	0.75	2.26	8.90	16.26	31.05
2	0.05	0.00	1.58	5.60	2.160	25.90
3	1.58	0.00	3.58	10.7	13.16	32.15
4	0.00	0.00	5.84	7.75	16.58	30.65
5	0.00	0.00	2.84	6.20	18.84	36.75
6	0.26	0.00	4.05	8.70	25.00	33.40
7	0.05	0.00	9.00	2.85	24.79	24.75
8	0.11	0.00	2.53	8.60	24.42	33.25
9	0.00	0.00	4.53	6.40	14.95	30.90
10	0.00	0.00	4.26	6.70	20.32	34.40
All periods	0.24	0.08	4.05	7.24	17.65	31.32
Period 1-5	0.39	0.15	3.22	7.83	13.40	31.30
Period 6-10	0.08	0.00	4.87	6.65	21.89	31.34

B A transcript of the instructions

In what follows we present a transcript of the instructions given to the subjects. Text in *italics* is only for clarification and was not revealed to subjects. Note also that the only piece of information that differs between the two treatments is the description of the auction formats (described in sections ”The Auction *Sealed bid*” and ”The Auction *Ascending*”, below)

General information

Welcome to this experiment on economic decision making! Read the instructions carefully. Do not talk during the experiment. If you have any questions, please raise your hand and one of the experimenters will approach you so that you can ask your question quietly. In the experiment you have the opportunity to earn money that will be paid out in cash at the end of the experiment. What ever happens in the experiment you are guaranteed a fixed earning of 50 kronor. In addition to this you can earn much more. How much depends on yours and the other participants' choices. In the experiment you will earn experimental ”daler” which will be exchanged for kronor at the exchange rate 2 daler = 1 kronor. The experiment consists of 10 rounds with the exact same structure. In addition to this there will be a practice round in order for you to familiarize with the software. Before the first round you will be placed in a group with two other participants. You will meet in the ten rounds of the experiment.

The Experiment

In each round of this experiment, you and the other two participants in your group will participate in an Auction. The auction ends when you are assigned one of three available items (denoted by A, B and C) or "no item". Objects A, B and C can only be assigned to one of the three participants in your group. For example, item A cannot be assigned to you and some other participant in the group. To the contrary, several participants in the group can be allocated "no item".

Resale value

Items A, B and C have a resale value which is visible on your screen (see Ruta 1, Figure 2 [Ruta 1 Figure 3 *in the ascending treatment*]). Note that the other participants in your group does not necessarily have the same resale values as you. If you are allocated an item, then the item will automatically be resold at the end of the round and you will receive the corresponding resale value in daler.

Price

If you are assigned item A, B or C, then you have to pay a price in daler. The prices for items A, B and C will be determined automatically by a computer program according to a predetermined rule which is based on the reports of all three members of the group. The price of "no item" is always zero.

Payoff

Your payoff in each round is given by the difference between the resale value and the price of the item that you are assigned, i.e.:

payoff = resale value – price

Information regarding your payoff and the item assigned to you will be available on your computer screen when the allocation procedure ends (see Figure 1). In addition, your accumulated payoff over all rounds will be available (see Ruta 2, Figure 2 [see Ruta 2, Figure 3 *in the ascending treatment*]). The total earning after period 10 will be paid out to you in cash before you leave (minimum amount 100 daler = 50 kronor).

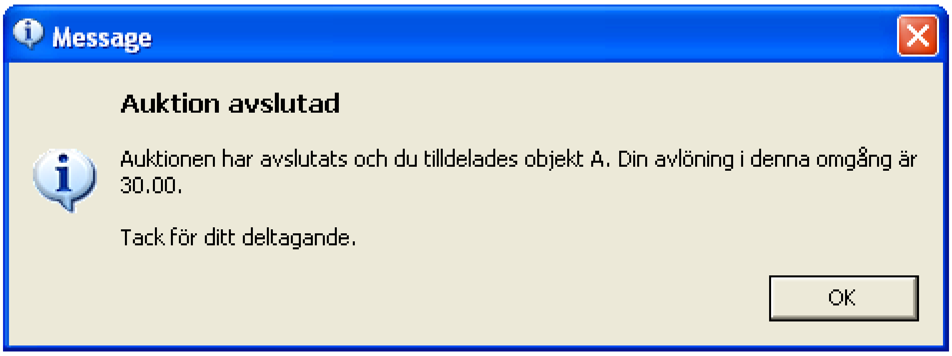

Figure 1:

The Auction *Sealed bid*

The assignment of items A, B and C and the prices will be determined by the following procedure:

Step 1 Please state on the computer, your willingness to pay for each item A, B and C (an integer number between 0 and 120). See Ruta 3, Figure 2. Note that you do not have to state any willingness to pay for ”no item” since it always equals zero.

Step 2 When you have stated your willingness to pay for each item A, B and C please press the ”Report” button (see Ruta 4, Figure 2).

Based on the willingness to pay that you and the other two participants have stated, prices and an assignment of items A, B and C will be determined by a computer program according to a predetermined rule. Each group member will be awarded the item where the difference between the stated valuation and the calculated price is the highest.

The Auction *Ascending*

The assignment of items A, B, and C and the prices will be determined by a simple procedure. In this procedure items A, B and C will have temporary prices which will be modified until the final prices can be determined (the temporary prices are visible in Ruta 3, Figure 3). The process consists of the following steps:

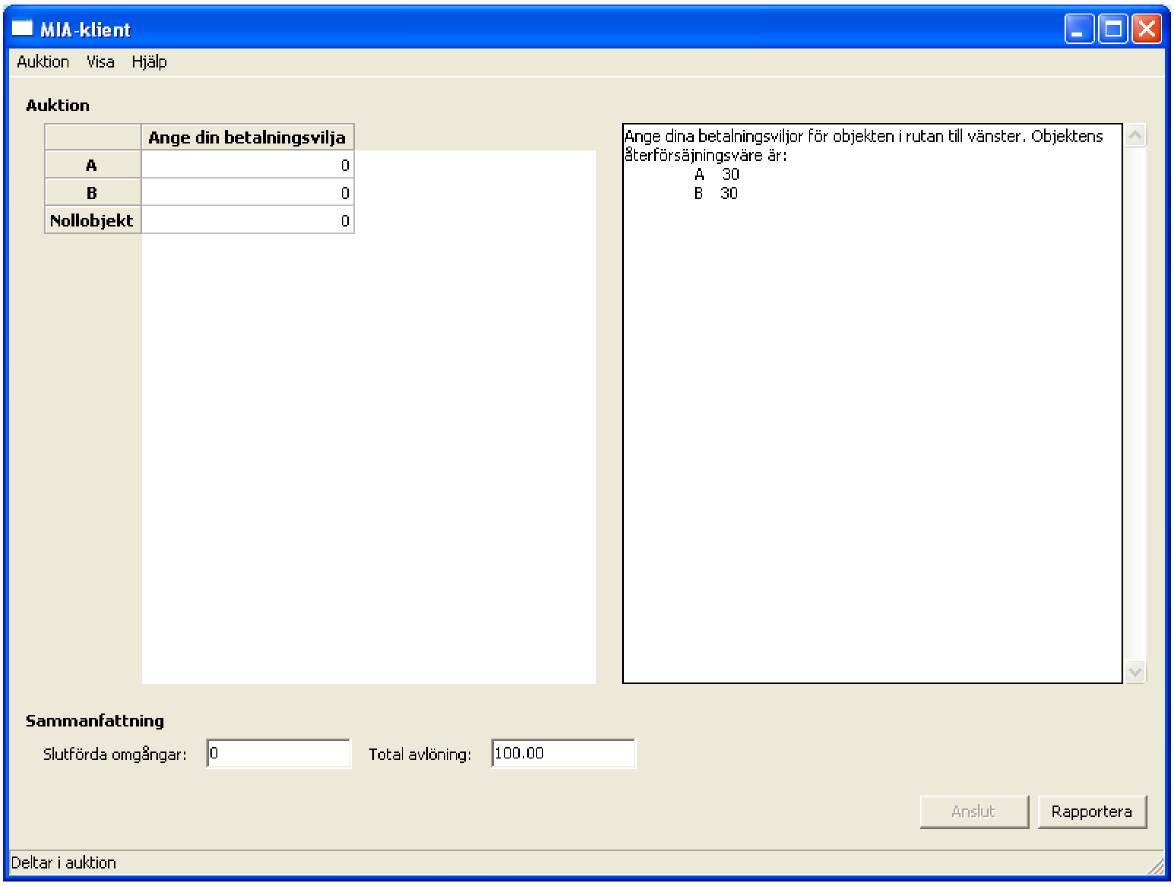

Figure 2:

Step 1 Given the temporary prices for items A, B and C, indicate on the computer screen by clicking the check box which item(s) you would prefer (see Ruta 4, Figure 3). If you do not want to be allocated any of the items you do not have to click any of the items.

Step 2 Indicate one of the three alternatives in Ruta 5, Figure 3.

Step 3 When you have carried out Steps 1 and 2 press the ”Report” button (see Ruta 6, Figure 3).

Step 4 If each group member can be assigned an item from his/her reported demand set, the auction is terminated and you will get your payoff for that round (see Figure 1). If this is not the case, the process continues to Step 5.

Step 5 Since it was impossible to find an assignment in Step 4, several participants have reported the same items in Steps 1 and 2. These participants shall now indicate on the computer screen (see Ruta 7, Figure 3) the minimal price increment which makes some other item equivalent to the items indicated in Steps 1 and 2. This price increment must be an integer number larger than zero. Then press the ”Report” button (see Ruta 6, Figure 3).

Step 6 Based on the reports in Step 5 the temporary prices will be updated automatically by a computer program according to a predetermined rule. The updated prices will be visible on your computer screen (see Ruta 3, Figure 3). The process then restarts from Step 1 for you and the other two participants.

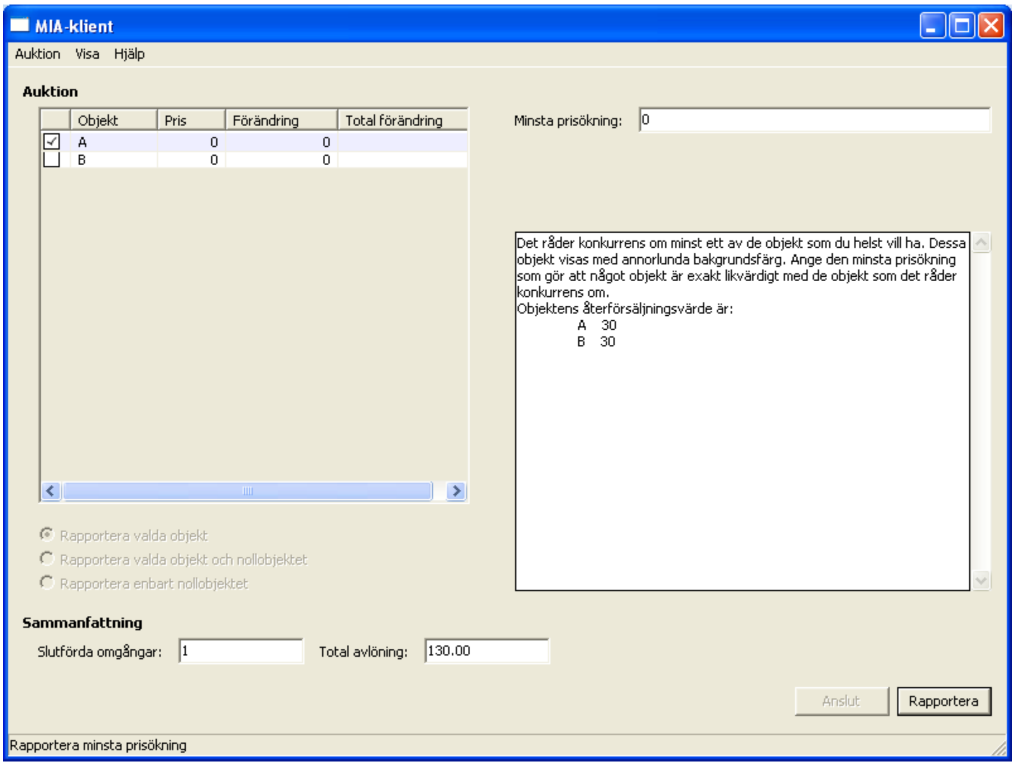

Figure 3: