

Trust Me: Communication and Competition in Psychological Games

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Abstract

We study theoretically and experimentally a communication market game with and without competition between senders (sellers) and embed it in the framework of a psychological game where players experience a wide range of emotions. While theoretically the effect of competition on market outcomes is ambiguous, empirically, we find that competition is welfare decreasing. This result is driven by an increase in the amount of lying that competing sellers engage in order to attract business from buyers and from the fact that buyers fail to recognize these lies and tend to believe these messages more than they should.