Mutual monitoring in team with a mediator

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Abstract

We analyze an infinitely repeated prisoner's dilemma with a mediator under costly monitoring. Players have to pay observation costs to observe the actions chosen by the opponent in the current period. Otherwise, he cannot obtain information about the actions chosen by the opponent. We introduce a non-dynamic mediator into our stage game. The mediator sends correlated recommendations to each player at the beginning of each stage game. We demonstrate that the mediator can facilitate mutual monitoring by sending recommendations, and for arbitrary high observation cost, Pareto-efficient outcome can be approximated by a sequential equilibrium.

Keywords Costly observation; Efficiency; Prisoner's dilemma
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