

In the microeconomic theory course, you learnt about supply and demand, market-clearing prices, market efficiency, welfare, and more, under the unrealistic assumption that all information is freely available to anyone. The concepts covered in this course will enable you to understand certain market inefficiencies and aspects of the organizational design of economic activities, which may be traced to informational asymmetries. As in the microeconomics course, ideas will be developed using models (graphical and mathematical).

Texts

The required textbook is The Economics of Information, by Ian Molho (Blackwell Publishers, 1997). Other required readings (see outline) will be distributed during the course.

Prerequisites

Microeconomic theory (EC201 or EC203) and calculus.

Exams, problem sets and grading

There will be one mid-term exam in class (the date will be announced at least three weeks in advance), and one final exam (scheduled on May 9 at 9.00). Each exam will count for 35% of the final grade (the final exam is not cumulative). The remaining 30% will be determined by your grades on problem sets, and by your class participation. Late problem sets will not be accepted, and no make-up exams will be given.

Note:

Although you may discuss problem sets with others, the work you hand in should be yours alone. Solutions that are too similar will get a low grade.

Office hours

Wednesdays 12.30 - 3.30, and by appointment.

Preliminary Outline

I. Introduction

- A. Review of microeconomic theory
- B. Some mathematical tools Appendix
- C. Introducing informational asymmetries Ch. 1

II. Adverse selection

- A. The market for lemons ①, Ch. 2
- B. Extensions of the basic model
- C. Experimental and empirical evidence Ch. 4

III. Extracting information (1): Signalling

- A. Bayes's rule Appendix
- B. A model of signalling ②, Ch. 5
- C. Experimental and empirical evidence Ch. 8

IV. Extracting information (2): Screening

③, Ch. 6

V. Moral hazard

- A. Introduction ④, Ch. 9
- B. The principal-agent model Ch. 10
- C. Extensions and evidence Ch. 11
- D. Moral hazard in insurance

① Akerlof, G.A. (1970) "The Market for 'Lemons': Quality Uncertainty and the Market Mechanism," *Quarterly Journal of Economics*, 84: 488-500.

② Spence, M. (1973) "Job Market Signaling," *Quarterly Journal of Economics*, 87: 355-374.

③ Rothschild, M. and J. Stiglitz (1976) "Equilibrium in Competitive Insurance Markets: An Essay on the Economics of Imperfect Information," *Quarterly Journal of Economics*, 90:629-649.

④ Milgrom, P. and J. Roberts (1990) *Economics, Organization and Management* (Chapter 6). Englewood Cliffs: Prentice Hall.