

19-Lecture-19-Adverse-Selection

1 What is the equilibrium selling price of *used* cars?

- A $P_U = E[S_U] = (1 - \lambda) \cdot 32,000 + \lambda \cdot 16,000$
- B $P_U = E[S_U] = (1 - \lambda) \cdot 40,000 + \lambda \cdot 20,000$
- ☒ C Neither of the above
- D Indeterminant

2 Q: What is the Nash equilibrium of the Prisoner's Dilemma game?

Tom

	Confess	Deny
Robin	Confess 3 yr / 3 yr	Deny 1 yr / 10 yr
	Deny 10 yr / 1 yr	Deny 2 yr / 2 yr

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- A Both cooperate
- B One cooperates, one defects
- ☒ C Both defect

3 What is the Nash equilibrium of the Rock, Paper, Scissors game?

- A Rock
- B Paper
- C Scissors
- ☒ D Something else

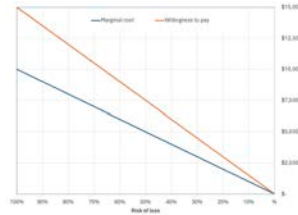
SURVEY

4 Which sellers will want to get a free appraisal?

- A Nobody
- B Everyone
- C Sellers with above average paintings
- D Sellers with below average paintings

SURVEY

5 Is it economically efficient for everyone in this market to get health insurance?



- A Yes: Pareto improving
- B No: Not Pareto improving
- C Indeterminant

6 How should the insurance company set policy price I given that it cannot determine individual risk?

- A Set $I = E[L] = 0.5 \cdot 10,000 = 5,000$
- B Set $I = 1.5 \cdot E[L] = 0.5 \cdot 10,000 = 7,500$
- ☒ C Set $I = 1.5 \cdot E[L | P = I]$
- D Don't sell insurance!

7 Why doesn't *everyone* buy insurance given that:

1. Everyone is risk-averse: they're willing to pay 50% above their expected cost, *and*
2. The insurance company is charging actuarially fair prices?

- A Risk averse people can't do math
- B Insurance companies can't be trusted
- ☒ C Low-risk buyers are subsidizing high-risk buyers
- D High-risk buyers are subsidizing low-risk buyers

8 Why doesn't the market completely *unravel* (no insurance sales whatsoever) given that low-risk buyers are implicitly subsidizing high-risk buyers – i.e., they're getting a raw deal?

- A Low-risk buyers are more altruistic than average
- B Low-risk buyers can't do math
- ☒ C Because of risk aversion, buyers will take an actuarially unfair deal – though there's an upper limit

SURVEY

- 9 Would it be (1) socially efficient *and* (2) Pareto-improving to mandate that *everyone* buy insurance at cost $I = \$, 5000$?
- A Neither socially efficient nor Pareto-improving
 - B Socially efficient *not* Pareto-improving
 - C *Not* socially efficient *but* Pareto-improving
 - D Socially efficient *and* Pareto-improving

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