Youngberg

Econ 304—Bethany College

**Homework 02**

Answer all the following on a ***typed, stapled*** (if applicable)separate sheet of paper. Make sure that you justify your answers, use your own words, and show your work. All questions are equally weighted.

1. Provide an example of adverse selection and moral hazard not covered in class. Briefly justify your answer.
2. Leeson discusses the importance of a separating equilibrium in “Ordeals.” What is a separating equilibrium and how is it used (or, how does it manifest) in the paper?
3. Suppose Akerlof were to redo his famous paper with the following utility functions:

$$U\_{1}=\frac{1}{2}\sum\_{i=1}^{N}x\_{i}; U\_{2}=\frac{4}{3}\sum\_{i=1}^{N}x\_{i}$$

Rewrite the total demand curves as indicated in Lecture 06.IV.b. Show your work. Do you reach the same conclusion as Akerlof? Justify your answer. (HINT: *μ* still equals *p/2*.)

1. The movie *The Invention of Lying* imagines a world where not only everyone tells the truth but also volunteers information, (often embarrassing). As a result, everyone believes what everyone else tells them—there is no word for “lie.” If we lived in that world, what problems associated with our healthcare system would go away and which would remain? Be sure to justify your answer.
2. We laugh at the idea that ordeals were a sound system of justice but as Leeson argues, this was actually a pretty good method for the time. What aspects of this system of justice would work in modern society and what ways wouldn’t? Justify your answer.