

Topic 13

Frontiers of Microeconomics

- Asymmetric information
- Political economy
- Behavioral economics

Asymmetric Information

- Hidden actions: Principals, Agents, and Moral hazard

Better monitoring

High wages

Delayed payment

- Hidden characteristics: Adverse selection and the Lemons Problem

- Signaling to convey Private Information

Case study: gift as signals

- Screening to induce Information Revelation
- Asymmetric Information and Public Policy

Political Economy

- The voting Paradox
- Arrow's Impossible Theorem
- The Median Voter is King
- Politicians are People Too

Behavioral Economics

- People aren't always rational

People are overconfident

People give too much weight to a small number of vivid observation

People are reluctant to change their minds

- People care about Fairness
- People are inconsistent over time

Diminishing sensitivity I

Buying a calculator for \$15

The sales person tells you that you can buy the same calculator for \$8 by walking 15 min to the other store. Would you do it?

Buying a suit for \$1,165

The sales person tells you that you can buy the same suit for \$1,158 by walking 15 min to the other store. Would you do it?

Sunk cost

- The investment size should not be relevant to the decision to continue or not.
- This is called the sunk cost effect
- Losses are more painful
- So we try to eliminate or delay them
- Thus, invest more because we are already “deep into it”

Loss aversion

Which would you choose

- A sure gain of \$240
- 25 % to win \$1,000 and 75% to win 0

Which would you choose

- A sure loss of \$240
- 25 % to lose \$1,000 and 75% to lose 0

- Conclusion