Theory of the Firm, Fall 2016

Problem Set 2

Rules: (1) Submission deadline is **October 5th at 16:30** in class or by e-mail (only typed solutions by e-mail). (2) Feel free to consult with your colleagues and any materials, but submit your own solutions. Have fun!

Problem 2.1
Give your own examples of:

1) Vertical product differentiation. Discuss whether you think that the products offered by the firm(s) are close to social optimum or there are distortions?

2) Horizontal product differentiation. Discuss whether you think that the firm(s) provide the right amount of diversity?

3) A market with potential for moral hazard. Discuss: does it create market failures or are there some factors that help to overcome the problem?

4) A market with potential for adverse selection. Again discuss: are there market failures or some reasons why the adverse selection problem is not as bad as one would expect.

In each case, please find examples other than those we discussed in class. 2–4 sentences are sufficient for each question.

Problem 2.2
Exercise 2.1* (page 103).

Problem 2.3
Exercise 2.2* (page 104).