

The Last One!

Place your name on the back of this sheet of paper and nowhere else. Staple your answers face up on the front of this sheet of paper. Failure to follow these directions will cost you 1 point. Your assignment will be typed, except graphs can be drawn by hand and mathematical equations can be done by hand. Failure to type it will cost you 10 points. If you use double-sided printing or print on the back of scrap paper, I will give you one additional point.

- 1) (25 points) Using two graphs, explain how adverse selection causes the *lemons problem*. Make sure you explain why the curve(s) moved. Why does the D_L curve end up back at the original line? Why is the final price in both markets the same? Why are there no high quality cars on the market?
- 2) (15 points) Use concepts in this chapter to explain why Obama's health care program will eventually require everybody to get health insurance.
- 3) (20 points) What is *moral hazard*? How do banks reduce the problem when they make a loan?
- 4) (15 points) Assume that a college education gives you no additional productivity. (Ignore the fact that this is a wrong assumption.) What is the economic reason for getting an education?
- 5) (15 points) Suppose a bank is worried about *adverse selection*. Should they raise or lower interest rates on loans? (What would happen to the pool of applicants when the interest rate changes?)
- 6) (10 points) What is the *principal-agent problem*?