

Externalities

Q1. - car theft +

- club - steering lock

- Lojack - tracking

negative externality? - club

- no reduction in theft

spillover falls on other drivers

pos. ext - Lojack - catch thieves

Flu shot - own risk

- spread ↓

Fryer fat/oil - Transfats - replace oils
more frequently

Forest fire - "Firewise"

↳ reduce intensity of fire
→ Firewise label - without - no fire protection

Information - pure public good

- non-rival.

- non-excludable

Moral Hazard - unobservable action

↳ raise cost to

Adverse selection

other party

- incentive to take

care

- deductibles] - imposing cost

- co-pay fail to take care

↳ pool higher risk than average population

↳ mandate coverage -

- Health Ins.

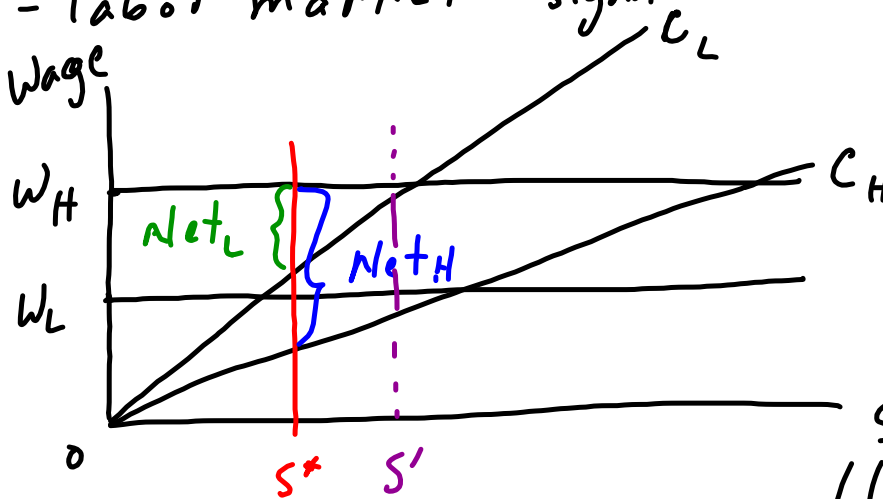
Insurance → pool insured.
↳ uncorrelated risk
no relationship across risk

- individual - fire
- theft - epidemics excluded.
- health

- natural disasters - Fed Insurance
↳ pooling geographically

Screen → "signal" of quality
 low quality cost of signal higher than
 for high quality

- labor market - signal - education



$$W_H - C_L < W_L$$

$$W_H - C_H > W_L$$

- Signal S^* get W_H

- W_L - no signal!

Signal.
 (level of education)

separating equilibrium - H & L

Signals - sent by seller

Screen - set by buyer

Buyer chooses level of screen (required signal) to separate Low + High quality sellers