

ECO 300 – MICROECONOMIC THEORY – FALL 2005  
QUESTIONS FOR PRECEPTS WEEK 12 – DECEMBER 14

Discuss the following situations or statements from the point of view of the theory of asymmetric information, including theories of signaling and screening.

(a) A house painter has a long-term arrangement with a particular builder, who calls on him whenever he needs any painting done. The painter is quite good at estimating the cost of these jobs – sometimes a little high, sometimes a little low, but correct on average. When this regular work is slack, he competitively bids for other jobs from other builders or homeowners. “Those jobs are different,” he says. “They generally end up costing more than I had estimated they would when I bid for them.” In fact his skill at estimation on the two types of jobs is no different; even on the competitive jobs his estimate of cost is correct on average. What can then explain his experience?

(b) Mozart moved from Salzburg to Vienna in 1781, hoping for a position at the Hapsburg court. But instead of applying for a position, he waited for the Emperor to call him, because “if one makes any move oneself, one receives less pay.”

(c) “Mr. Robinson pretty much concludes that business schools are a sifting device - M.B.A. degrees are union cards for yuppies. But perhaps the most important fact about the Stanford business school is that all meaningful sifting occurs before the first class begins. No messy weeding is done within the walls. ‘They don't want you to flunk. They want you to become a rich alum who'll give a lot of money to the school.’ But one wonders: If corporations are abdicating to the Stanford admissions office the responsibility for selecting young managers, why don't they simply replace their personnel departments with Stanford admissions officers, and eliminate the spurious education? Does the very act of throwing away a lot of money and two years of one's life demonstrate a commitment to business that employers find appealing?” (From the review of Peter Robinson's book, *Snapshots from Hell: The Making of an MBA*, by Michael Lewis (Princeton '82, majored in Art History). *New York Times Book Review*, May 8, 1994.)

(d) What problems of information and incentives will arise if a government tries to put into practice the Marxist idealism of “From each according to his abilities, to each according to his needs”? Suggest how the government might try to solve these problems.