Sample Homework Problems from the Last Lecture

1. Each of the following situations involves moral hazard. In each case, identify the principal and the agent, and explain why there is asymmetric information. How does the action described reduce the problem of moral hazard?
   a. Landlords require tenants to pay security deposits.
   
   b. Firms compensate top executives with options to buy company stock at a given price in the future.
   
   c. Car insurance companies offer discounts to customers who install antitheft devices in their cars.

2. Provide an example that violates each of the following principles:
   a. unanimity
   
   b. transitivity
   
   c. independence of irrelevant alternatives
   
   d. no dictators

3. State Arrow’s Impossibilities Theorem in your own words. What does this imply about a democracy’s ability to make good decisions?