

Economics 251: Price and Allocation Theory

Reading Guide: “The Market for Lemons: Quality Uncertainty and the Market Mechanism”

Professor Akerlof’s article is not overly technical, so you should be able to read it straight through. You should read section III.A, but you can skip Sections III.B, III.C, and III.D.

Review Questions:

1. What are the four types of cars that Professor Akerlof refers to?
2. What is a **lemon**?
3. What does the parameter q represent?
4. What is the information asymmetry at the heart of the model?
5. What do you think Professor Akerlof means when he says “Again realism is sacrificed to avoid a diversion from the proper focus.”?
6. What is the main prediction of Professor Akerlof’s model?
7. Why is the situation different when buyers and sellers both have incomplete information?
8. According to Professor Akerlof, why is it difficult for older people to purchase health insurance?
9. According to Professor Akerlof, what institutions arise to counteract the information asymmetries inherent in many market settings?