

31E99906 Capstone Microeconomic Policy

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Return method: through mycourses by the deadline

Problem Set 2: Question 2

Contracts, private information, and information rent. Let the social demand for a service be $S'(q) = 10 - q$ where $S(q)$ is the social gross surplus. The service can be contracted from a private provider with cost function $c(q, \theta) = \theta q$ where θ can take values $\theta \in \{2, 6\}$. Thus, there are two potential types, and the regulator does not know the type she is dealing with.

1. What would be the socially optimal service level q for each type?
2. How much does the regulator need to pay to type $\theta = 2$ to make sure that the firm produces the socially optimal level?