

“The Market for ‘Lemons’: Quality Uncertainty and the Market Mechanism”
George Akerlof

Discussion Questions

1. Why, according to Akerlof, can asymmetric information about product quality lead to market failure?
 - a. What does Akerlof mean by “adverse selection”. By market failure?
 - b. What is the connection between adverse selection and market failure?
 - c. What, according to Akerlof, is the market failure in the used car market? The medical insurance market? The developing country credit market?
 - d. How does Akerlof use asymmetric information and adverse selection to explain the unwillingness of some employers to hire minority applicants?
 - e. What did George Stigler mean when he said “...in a regime of ignorance Enrico Fermi would have been a gardener...”?
 - f. Why, according to Akerlof, are the costs of dishonesty greater than the amount by which people are cheated?

2. What, according to Akerlof, are remedies for the lemons problem?
 - a. How does joining an association like a “managing agency” provide a remedy for firms?
 - b. In what sense is borrowing from family members a remedy?
 - c. Why is Medicare a remedy?
 - d. How would you use Akerlof’s ideas to explain the business plan of *CarMax* (www.carmax.com)?

3. In your view, is adverse selection an important economic problem?
 - a. Is adverse selection a powerful economic concept?
 - b. Should consideration of adverse selection guide economic policy?
 - c. What kinds of policy should pay particular attention to the problems of asymmetric information and adverse selection?