

PROBLEM SET 3

- Consider the bilateral bargaining (“lemons”) model we discussed in class. Suppose that the payoffs are now:

$$u_1(a_1, a_2, \theta_1) = \begin{cases} \frac{a_1+a_2}{2} - \theta_1 & \text{if } a_1 \leq a_2 \\ 0 & \text{if } a_1 > a_2 \end{cases}$$

for the seller and

$$u_2(a_1, a_2, \theta_1) = \begin{cases} \gamma\theta_1 - \frac{a_1+a_2}{2} & \text{if } a_1 \leq a_2 \\ 0 & \text{if } a_1 > a_2 \end{cases}$$

for the buyer, where $2 > \gamma > 1$.

Prove that the result we found in class is still true. Why is this situation so much worse than the situation we found in class?

- From Osborne’s book: 282.1, 282.2, 284.1, 296.1, 307.1.