

ECO381 – Summer 2010

Assignment 2

Due: August 5, 2010, 5:10 P.M.

Consider one of the following statements:

- *Adolescents eat too much fast food.*
- *People do not recycle enough.*
- *Too many marriages fail.*
- *Children do not read enough books.*
- *Too many politicians are corrupt.*

1. Interpret the statement in terms of economic efficiency and explain how you would determine the efficient outcome.
2. Interpret this problem in terms of the principal-agent relationship.
3. Explain how the incentive problem can contribute to the inefficient outcome identified in the statement.
4. Design an optimal piece rate contract to solve the incentive problem. Explain how each of the following factors will affect the contract design:
 - Risk attitudes
 - Multiple signals
 - Multitasking
5. Design an optimal tournament contract to solve the incentive problem. Discuss factors that would affect whether the tournament contract would be preferred to the piece rate contract for this problem.

Guidelines

1. You are encouraged to form a group with another 1 to 3 students and submit a single assignment for the group. All students in the group will receive the same grade. You also have an option to work alone.
2. The assignment should be typed on a double-sided paper. It should not exceed 1,500 words (approximately 3 pages).