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Xiang Sun, Yeneng Sun, Lei Wu, Nicholas C. Yannelis

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Equilibria and Incentives in Private Information Economies[☆]

Xiang Sun

Economics and Management School, Wuhan University, 299 Bayi Road, Wuhan, 430072, China

Yeneng Sun

Department of Economics, National University of Singapore, 1 Arts Link, Singapore 117570

Lei Wu

JPMorgan Chase, 168 Robinson Road, Captical Tower, Singapore 068912

Nicholas C. Yannelis[*]

Department of Economics, Henry B. Tippie College of Business, The University of Iowa, 108 John Pappajohn Business Building, Iowa City, IA 52242-1994, United States

Abstract

This paper considers three solution concepts in a large private information economy, namely, Walrasian expectations equilibrium, private core, and insurance equilibrium. It shows that these three concepts coincide with each other when the agents are informationally negligible in such an economy. In contrast to the finite-agent setting, one can construct a large private information economy in which incentive compatibility fails completely in the sense that almost every agent in any Walrasian expectations equilibrium/private core/insurance equilibrium allocation has the incentive to misreport her type.

Keywords: Asymmetric information, Incentive compatibility, Insurance equilibrium, Private core, Private information economy, Walrasian expectations equilibrium
JEL: D50, D70, D81, D82

1. Introduction

It is well-known that in a finite-agent private information economy, it is in general not possible to write contracts that are incentive compatible, individually rational and Pareto efficient. On the other hand, one may hope that such an inconsistency problem disappears in a large market where the informational

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[*]Corresponding author

Email addresses: xiangsun.econ@gmail.com (Xiang Sun), ynsun@nus.edu.sg (Yeneng Sun), lei.wu.web@gmail.com (Lei Wu), nicholasyannelis@gmail.com (Nicholas C. Yannelis)

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