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Equilibria and Incentives in Private Information Economies[☆]

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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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