Edexcel (A) Economics A-level

Theme 1: Introduction to Markets and Market Failure

1.3 Market Failure

1.3.4 Information gaps

Notes

- **Symmetric information** means that consumers and producers have perfect market information to make their decision. This leads to an efficient allocation of resources.

- **Asymmetric information** leads to market failure. This is when there is unequal knowledge between consumers and producers. For example, a car dealer might know about a fault with the car that the consumer is unaware of. This could lead to a misallocation of resources. Consumers can also know more information than the producer, such as when purchasing insurance policies.

- There could also be imperfect information, where information is missing, so an informed decision cannot be made.

- This leads to a misallocation of resources. Consumers might pay too much or too little, and firms might produce the incorrect amount. For example, monopolies might exploit the consumer by charging them more than they need to.

- Asymmetric information can be linked with the **principal-agent problem.** This is when the agent makes decisions for the principal, but the agent is inclined to act in their own interests, rather than those of the principal. For example, shareholders and managers have different objectives which might conflict. Managers might choose to make a personal gain, rather than maximise the dividends of the shareholders.

- Information could be made more widely available through advertising or government intervention. For example, the harmful effects of smoking could be made public through adverts and messages on cigarette boxes.