

AQA Economics AS-level **Microeconomics**







Topic 5: Market Mechanism,
Market Failure and Government
Intervention in Markets

5.6 Market imperfections




Notes





Imperfect and asymmetric information

-  **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.







Immobility of the factors of production

-  The mobility of Labour is the ability of workers to change between jobs. Unemployment is evidence that labour markets do not work efficiently.
-  Frictional unemployment may exist whilst people move between jobs and search for new ones.
-  Structural unemployment occurs when there is a decline in an industry. This can mean worker skills do not match the location and skills required for the job. This is more serious.



-  The geographical immobility of the factors of production refers to the obstacles which prevent the factors of production moving between areas. For example, labour might find it hard to find work due to family and social ties, the financial costs involved with moving, imperfect market knowledge on work and the regional variations in house prices and living costs across the UK.
-  The occupational immobility of the factors of production refers to the obstacles which prevent the factors of production changing their use. For example, labour might find it difficult to change the occupation. This occurred in the UK with the collapse of the mining industry, when workers did not have transferable skills to find other work. The causes include insufficient education, training and skills.

Monopoly and monopoly power

-  The basic model of monopoly suggests that higher prices and profits and inefficiency may result in a misallocation of resources compared to the outcome in a competitive market.
-  Monopolies could exploit the consumer by charging them higher prices.
-  This means the good is under-consumed, so consumer needs and wants are not fully met.
-  This loss of allocative efficiency is a form of market failure.
-  Monopolies have no incentive to become more efficient, because they have few or no competitors, so production costs are high.
-  There is a loss of consumer surplus and a gain of producer surplus.

