

Information Gaps

Information gaps occur when buyers and sellers do not have full or equal information about a product. This weakens the price mechanism and can lead to market failure, as the assumption of perfect, symmetric information rarely holds in real-world markets.

Key definitions

Symmetric information exists when buyers and sellers have the same information.

Asymmetric information occurs when one side has more information than the other.

Imperfect information means that one or both sides lack full information.

Consumers' Lack of Awareness

Information gaps can cause market failure when consumers misunderstand long-term benefits or harms. This leads to incorrect demand thus a missallocation of resources .

For **merit goods**, underestimating long-term benefits results in low demand and underconsumption, so too few resources are allocated (e.g. education and healthcare). With full information, demand would shift right and quantity would rise.

For **demerit goods**, underestimating long-term harms leads to high demand and overconsumption, so too many resources are allocated (e.g. cigarettes and alcohol). With full information, demand would shift left and quantity would fall.

Asymmetric Information

Asymmetric information occurs when one party in a transaction has more information than the other. This distorts prices and quantities away from the socially optimal outcome and causes a misallocation of resources.

In some markets, consumers would buy less if they knew the true risks and more if they knew the true benefits. A common example is the used car market in the UK , where sellers usually know more about goods quality than buyers and common issues arise like Odometer Fraud (Better known as clocking back the mileage) .

Moral hazard

Moral hazard arises when protection from risk encourages riskier behaviour because actions are difficult to observe. For example, insured individuals may take less care of their health, or patients may overuse healthcare when it is free at the point of use.