Introduction to asymmetry of information

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Critique by George Akerlof.

Notion of « a population being fairly reasonable »

# Structure of the Class

1. Efficiency and Inefficiency of the markets [SES101 kekw]
   1. Classroom Experiment
2. Concept of Adverse Selection

3.

4.

1.Once you let people do their business, a few things will happen :

In order to reach maximum utility, exchanges generate surplus.  
Competitive markets in particular ensure the surplus maximization.  
Sellers and buyers share then the information (typical SES101)

Now, let’s introduce another factor : the notion of quality.

In the previous case, the example was 100 pokemon cards, all the same, all new.

Now, we introduce « Damaged », (Lowquality) vs « New » (Highquality), 50 of each.

There is here a little various in the info each one has access to to.

Experiment with buyers/sellers with the 4 students. What we notice is that when the buyers don’t have the information on the quality, but only on the price, there is an exchange that will be made but that will NOT value the buyer.

What we see is that prices of sellers quite match their own price of buying in the first rounds. HOWEVER, once tbe buyer is not given the information about the quality of the goods he gets, prices don’t drop, while qulity does. He gets f\*cked in the process, and that’s what we call capitalism. Right ?

The only conclusion we can actually have is that people like to cheat their customers when they can.

How to reduce the asymmetry of information ? Well, it’s not that easy. Because sellers can scam the customers by making them think they provided a warranty for quality when in fact they did not.

Mechanisms can be put in place : the notion of trust is hard to build, but will benefit both the seller and the buyer. The notion of trust can also be shared with other people, through ratings. But those can be falsified, so… Another mechanism is to go to a third-party person to check your good (like a mechanic for a car) and evaluate bot hits quality and its price, sometimes. You can also be your own third-party, like for example in AirBnB, you can take a LOT of pictures of your apartmnent in order to sel lit the most objective way possible.

Your reputation is a way to enforce your gamble. The buyer will share the good experience they had with you and you will gain more buyers, leading to more benefits, even if you made less in the short-term. Building a reputation takes time, but not scamming your customers will ensure you have a strong selling base.

In fact, after many transactions, buyers are aware of the quality of your goods. Fool them once, shame on them. Fool them twice, shame on you !

You can also SIGNAL sellers. This remins me a lot of the trading my brother used to do in Rocket League. He could signal scammers and would only trade with other high-reputation traders. Once, he lost a lot on a trade with a scammer and he stopped trading after that.

Sellers can obtain certification for quality (*a student a can to a prestigious school, it’zs like an education warranty*). A certification for quality is more difficult to obtain for low-quality sellers. It adds extra effort into the process. BUT signaling can have a reverse effect : it reduces the asymmetry of info but we have to add the (inefficient (as it did not concern the product itself)) effort to obtain it.

Concluson : When sellers have more information that sellers, markets do not work well.

The presence of Low-Quality sellers creates a negative externality over high-quality sellers.

You can build yourself a reputation to gain regular clients. This is like a top-tier warranty for quality.