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12 The Economics of Information

Cost of information – Opportunity cost of time spent searching, rises as more is gained

Benefit of information – Gains in surplus from using it, e.g. money saved finding a better deal

The optimal amount of information – Marginal benefit = marginal cost

Gamble inherent in search – Don't know what the benefits of information will be (will I find a much cheaper deal or waste my time and find nothing?)

Asymmetric information – buyers and sellers aren't equally informed, e.g. sellers knows quality better

Principal – Someone who contracts another to perform a service on their behalf

Agent – Someone who is contracted to work on a principal's behalf

Principal-agent problem – Principals and agents have different values. Agent could in self-interest against the best interests of the principal and monitoring an agent's actions can be costly.

The Market for Lemons model – Asymmetric information leads to deterioration in value of goods. Buyers offer average price for both good and bad (lemons) goods; sellers with above average goods leave the market because they aren't offered good prices, sellers of lemons flood the market to make surplus.

Adverse selection – Buyer exploits asymmetric information before a transaction, e.g. terminally ill person buying life insurance

Moral Hazard – Buyer exploits asymmetric information after a transaction, e.g. person with car insurance drives more dangerously knowing they're covered

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