

## CONCEPT: ASYMMETRIC INFORMATION

- To this point, we have assumed that all parties in a transaction have **complete information**.

- ☐ **Complete Information** – the state of being \_\_\_\_\_ regarding an economic choice
- ☐ **Private Information** – knowing something others don't know
- ☐ **Information Asymmetry** – the situation where one party \_\_\_\_\_ than another party
  - Drivers may be \_\_\_\_\_ when they have car insurance
  - Used Car Salesmen \_\_\_\_\_ about the cars they are selling than the customers
  - Patients \_\_\_\_\_ about their health condition than insurance companies

- Information asymmetry leads to two informational problems:

- ☐ **Adverse Selection** – entering agreements where \_\_\_\_\_ is used for an advantage

 - Adverse Selection relates to \_\_\_\_\_ characteristics and occurs \_\_\_\_\_ a transaction

<u>Used Car Sale</u>	<u>Health Insurance</u>
Knows the secret: _____	Knows the secret: _____
Secret: _____	Secret: _____
Result: _____	Result: _____
Even worse: Willingness to pay ____, Good cars ____	Even worse: Premiums ____, Healthy policyholders ____

- ☐ **Moral Hazard** – a party to a contract altering his behavior \_\_\_\_\_ a contract is made

 - **Principal** – a person who entrusts someone (i.e. the \_\_\_\_\_) with a task

- **Agent** – a person who carries out a task on someone's (i.e. the \_\_\_\_\_) behalf

<u>Employer-Employee Relationship</u>	<u>Insurer-Insured Relationship</u>
Principal: _____	Principal: _____
Agent: _____	Agent: _____
Moral Hazard: _____	Moral Hazard: _____ effort to prevent losses