INFORMATION ASYMMETRY, LAW AND COMPETITION

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Abstract: *Information Asymmetry among negotiating parties and market participants is a persistent phenomenon which can be bridged but cannot be eliminated. The 'felt' effects of information asymmetry would be sector and character specific. In evolving markets, dominated by service sectors, the phenomenon is posing challenges and many such challenges are beyond easy capture, particularly in intangible assets which are important from consumer and societal angles. Competition Authorities through their interpretations and advocacy provisions would deal with emerging knowledge based industries to maintain a balance among all stake holders.*

Information asymmetry can be witnessed anywhere and everywhere, be it the case of buyer-seller, recruiter-interviewer, classifieds (matrimonials, rentals, sales), media government and citizens. In fact, from the cradle to the grave at each turn for the next step one has to face the issue of information asymmetry at a considerable cost and time investment. Entire learning process is targeted towards bridging information asymmetry and yet the more one traverses, the more the acuteness of information asymmetry. Perhaps, the persistence of asymmetry explains that one can strive to be perfect, yet absolute perfection would be deluding. The dilemma of information asymmetry is deepened as one is reminded that this is an age of information 'explosion,' an information 'revolution.' There are limitations associated with collection of information, its analysis and finally in its application. Life and time are finite; flow of information is unending and varied. Decisions have to be made within the stipulated time period giving due regard to biases of the parties. Therefore, notwithstanding the studies of George Akerlof sensitizing the market players about the concept of "market of lemons,"[1] the market of lemons continues to be an essential feature of market signifying the continuation of market-asymmetry and thus keeping the challenge alive for advocacy programmes of competition polices and also that of Competition Authorities. The asymmetry continued to be felt despite efforts by Michael Spence[2] to show ways of reducing its impact by way of generating and transmitting "signals" of its existence

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[1] Akerlof, Geroge A., A. Michael Spence and Joseph E. Stiglitz (2001), "The Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel 2001," Kungl Vetenskapsakademien, The Royal Swedish Academy of Sciences, *Nobelprize.org*

[2] *Ibid.*

and thus those having information deficit. In fact, Joseph Sliglitz *et. al.*[3] have time and again substantiated that economic models may be quite misleading if they disregard informational asymmetries.

The existence of information asymmetry is somewhat fundamental not only in market place, but elsewhere as well. In fact, its existence is the essential stimulus to the advancement of knowledge and challenges of narrowing the evolving gap in a befitting manner.

It is quite in order to believe that the information/knowledge generator would be having a large 'index' of information compared to the others. The information generated would be at a considerable cost and effort. Therefore, such an entity should have the "right to profit from their labours" and those who benefit from it should be paying for the same at best prices. Such a right has been duly recognised as Intellectual Property Right and many safeguards have been provided in favour of such an 'information bias.' However, problem does arise when barriers are created when information should have been flowing freely for an informed decision. For example, a vendor of goods and services manages to overstate the quality of his goods and services knowing well enough that the other parties in the transaction would have no means of verifying the same. Sometimes vendors manage to create a noise about their wares and services blaming the capability of other parties in making sound judgements. For example, in the Real Estate market as it is being practised in India, a situation is created that unless the buyer signs on the dotted line, he is not included in the market despite his willingness to pay, subject to his satisfaction about several claims being made by the vendor. The practice of such an information asymmetry needs to be addressed by placing suitable regulatory mechanisms which would create level playing fields for all parties in the market thereby ending the adverse selection by the investors who lack information while negotiating an agreed understanding of or contract to the transaction, and minimise moral hazard of the investor who lacks information about the performance of the agreed-upon transaction and also lacks the ability to retaliate for a breach of agreement.

USA enacted a federal 'lemon law' (the Magnuson-Moss Warranty Act) that protects citizens of all states. Different states have also enacted legislation on similar lines. These specific laws provide consumers with rights exceeding the warranties expressed in purchase

3 *Ibid.*

contracts. The federal law also provides that the warrantor may be obligated to pay your attorney fees if you prevail in a lemon law suit[4].

Government of India is also set to revamp the Consumer Protection Act, 1986 to provide for acting against unfair terms in contracts which are skewed in favour of service providers or manufacturers[5]. Such a move has been spurred by an initiative of Law Commission which had observed that there was need to protect consumers from the disadvantages of extensive introduction of standard terms of contracts which are one sided and were thus unfair contracts. Law Commission, citing developing laws in developed countries, recommended enactment of similar laws to protect the weaker party against the stronger. The Law Commission had characterised unfair terms in contracts into three categories—procedurally unfair, substantially unfair and voidable—which should be avoided. Law commission has felt that it has become necessary to provide additional provisions in India for redressal against unfair terms of contracts, apart from the existing provisions contained in the Indian Contract Act and Specific Relief Act. The Law Commission has foreseen that business and commerce in the country will be put to serious disadvantage if a new law regulating unfair terms of contract is not in place. The Law Commission panel was not impressed with the argument that such a law will actually affect foreign investment in the country as it was aware that such laws were already in place in countries such as the UK, the US, Canada, Australia and New Zealand.

Such a law, if enacted, would take care of the advantages derived by the parties on account of information asymmetry to a large extent and one sided contracts that are thrust upon on the consumers in unregulated or under regulated sectors, e.g., Real Estate, Education, Airlines, etc.

In evolving markets in emerging areas, the phenomenon of information asymmetry would pose challenges to both buyers and sellers. For example, a firm needing the services of a consultant to revamp its information system would need to determine the capability of the consultant in applying his professional skills to work out meaningful advisories for improving its functioning. Similarly, the consultant would also like to determine the level of existing manpower within the firm who would be interacting with him and his team to present a fair

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4 "The Market for Lemons" [Subsection: The Laws in the United States], Wikipedia, http://en.wikipedia.org/wiki/The_Market_for_Lemons.

5 Gupta, Surojit and Sidharta Sachin Parashar (2011), "Contracts Favouring Manufacturers to go: Government to Amend Consumer Law to End Unfair Terms," *Times of India*, New Delhi Edition, May 9.

picture of the existing competence and the future goal of the firm in the next time frame. Both the parties would be in a win-win situation only if the level of symmetry is within manageable bounds and to reach such a stage of confidence, diligence would be needed from both sides to arrive at a satisfactory contract. Naturally, there would be costs involved as *initial investment* from both sides.

For many sectors such as Education, Health, Municipal Services, etc., Government is finding ways to increase the role of the private sector. The achievements in these sectors are tangible and non-tangible, but in significance both are be equally material. For example, in the education sector, the ultimate task may be to impart appropriate skills for making the students worthy of consideration for labour market, yet a certain value system has to be imbibed in them to become informed and valuable participants of the democratic and secular society promoting an egalitarian approach. The task of skill development is tangible and the task of giving a value system is non-tangible—both tasks are equally significant. Therefore, the intending beneficiary would need to have a fair assessment of the worth of the competing institutions and the costs that it has to bear. The dilemma of information asymmetry would become sharper in the face of competition between the private and public institutions[6].

Professional users of services and goods would have institutional and professional services to take on information asymmetry to arrive at the true value of services and goods procured by them and would be able to do so in competitive manner. However, individuals would be driven more and more by their respective biases as has been observed in the Discussion Note on impact of “Behavioural Biases of Consumers and Competition Policy.”[7] The competition authorities and their advocacy wings would be required to take appropriate measures to ensure that despite persisting asymmetries, the market remains competitive, i.e., at its optimal level.

[6] Amagoh, Francis (2009), “Information Asymmetry and the Contracting Out Process,” *The Innovation Journal: The Public Sector Innovation Journal*, Vol. 14(2), Article 3.

[7] Sardana, M.M.K. (2011), “Behavioural Biases of Consumers and Competition Policy,” ISID Discussion Note DN1107, May.