

IP to address information asymmetries

Disparities of information between producers and consumers can be detrimental to the functioning of both markets for final products and financial markets. IP rights can help to reduce information asymmetries faced by consumers and investors by providing information about the characteristics and quality of the goods that they protect. Therefore policies aimed at educating the public about the role of IP rights as information providers will help consumers and investors to address the problems that information asymmetries entail.

What are information asymmetries?

Information asymmetry refers to the disparity of the level of information that each party has in a transaction. The problem with asymmetric information stems from the fact that the producer/seller knows the attributes and quality of their products/ company while consumers/investors do not and can only determine them through search or experience or cannot determine them at all. This information gap can lead to market information problems in the form of “adverse selection” (when the lack of information leads to undesired results) and “moral hazard” (when due to a lack of information, consumers act less carefully while leaving another party to bear the costs of their actions) (Akerlof, 1970).

Information asymmetries impact negatively the market: higher-quality products may be driven out of the market so that transactions will not materialize. Producers maintaining the quality of their products are exposed to unfair competition from producers who sell lower quality products at the same price (Bramley, Biénabe and Kirsten, 2009). This in turn may discourage producers to seek quality of products in the first place.

Some forms of IP rights can help to convey reliable information to third parties. In particular, trademarks and geographical indications (GIs) give information about the quality, characteristics and origin of products; but also patents and copyright-protected works serve to inform consumers’ and/or investors’ decisions.

How is IP related to information asymmetries and innovation?

IP rights can help reduce information asymmetries faced by innovators, not up to be generally speaking facilitating the disclosure of information regarding

Trademarks and GI

The economics underlying the protection of distinctive signs as trademarks and geographic indications (GI) is founded in the economic theories of information and reputation (Rangnekar, 2004; Ramello and Silva, 2006). In situations of asymmetrical information, reputation plays an important role by signalling a certain level of product quality to consumers. Such reputation can be communicated through various means that include the use of distinctive signs like trademarks and brands (Rangnekar, 2004). Trademarks help consumers distinguish quality features that are not observable at the moment of product purchase (Rangnekar, 2004; Baroncelli, Krivonos and Olarreaga, 2007). Trademarks help reduce search costs for consumers but they also help firms increase quality standards (Baroncelli, Krivonos and Olarreaga, 2007). In a market with information asymmetries, on the supply side, it would not be profitable for firms to incur higher costs for (unobservable) quality improvements if these could not be signaled to prospective customers to justify a higher sale price (Baroncelli, Krivonos and Olarreaga, 2007).

The reason for protecting geographical indications fundamentally derives from the fact that the place of origin may be used as a quality signal and that the resources of a region may be captured in the origin-labeled products as quality attributes (Pacciani et al., 2001). These resources could include aspects such as production techniques, varieties and species, but also resources that are general to

the region such as landscape, environment and culture (Pacciani et al., 2001; Bramley, Biénabe and Kirsten, 2009).

Patents

Patents can also be used to address information asymmetries, in particular on markets for finance and technology (see [IP and markets for finance](#) [1] and [Licensing and markets for IP](#) [2]). Notably, a strong patent portfolio in a specified area reassures would-be investors and collaborators in a firm that competing firms do not possess the relevant patent rights (Davis, 2010). Moreover, it can facilitate disclosure information on inventions inventors would otherwise prefer to keep secret from potential investors (out of fear they might not appropriate returns on IP). In that way it might also facilitate market transactions.

What are the policy implications of IP and information asymmetries?

It is important that governments provide information and assistance to both consumers and firms regarding the information that the different forms of IP rights provide and how they can interpret and use this information. At the same time, governments (as they do in many countries) can adopt consumer information policies to complement the information that IP provide, for example, by introducing label schemes which supply information about ingredients, material composition, production methods, packaging, storage, product origin, and so on (OECD, 2000). The role of consumer protection agencies is also particularly important in this respect.

Regarding IP and its role on markets for finance and technology, a range of other factors need to be in place for IP to be able to make such contributions (see [IP and markets for finance](#) [1] and [Licensing and markets for IP](#) [2]).

References

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