

Asymmetries of information

The other class of information problems leading to market failures arises from firm-specific information problems in which there are either informational asymmetries or informational economies of scale. These problems arise from a firm's need to search for partners, distributors, and suppliers; and from the difficulties in determining the quality of the services that they attempt to contract for. The evidence that social networks affect trade flows and patterns is evidence that these information issues are empirically relevant.

Intermediaries are a market response to these types of problems. The literature demonstrates how intermediaries can improve efficiency, but also shows that the first best outcome is unlikely to be achieved for various reasons, including market thinness, hold-up problems, network externalities, and asymmetries of information about the quality of the intermediaries themselves. There is relatively little empirical evidence regarding the effectiveness of intermediaries in facilitating international trade. One would expect that the market for intermediaries would be much more highly developed in some sectors and countries than in others; however this also remains a topic for future research.

The case for government intervention to provide firm-specific support to respond to these issues of asymmetric information is very weak because there is very little evidence on how well the intermediary market functions. There is a danger that government provision of services may crowd out private sector intermediaries. At the same time, policy could play a role in helping firms find suitable intermediaries, and in helping to transmit information about the quality and reputation of various intermediary services. Government consulate personnel may have a comparative advantage in providing certain types of intermediary services (such as in dealing with foreign officials); in such cases, there is an argument for government provision of such services (on a cost recovery basis).