4.1 Information and market power

Name: _____ Class: _____ Date: _____ **Total: 21 marks**

KEY WORDS asymmetric information • moral hazard

Information and market power

Objective

Distinguish adverse selection from moral hazard, solve the monopoly model with its welfare cost, and evaluate the policy responses to market power (syllabus 2.10–2.11).

1 Key knowledge and worked examples

Information and power toolkit. Asymmetric information fails markets through adverse selection (before the contract) and moral hazard (after). Monopoly: MR $= 70 - Q$ meets MC $= 10 + Q/2$ at $Q = 40$, price 50 on the demand curve; with ATC 30, supernormal profit $(50 - 30) \times 40 = 800$. The competitive benchmark $(60, 40)$ reveals the deadweight loss $\frac{1}{2} \times 20 \times 20 = 200$. Natural monopoly: regulate, do not fragment. CR4 from shares $40 + 25 + 15 + 10 = 90\%$.

2 Practice

2.1 Define asymmetric information and distinguish adverse selection from moral hazard by timing. [2]

2.2 Explain how a pooled insurance price causes adverse selection. [2]

2.3 Name any four barriers to entry that sustain monopoly. [2]

2.4 State the profit-maximisation condition and read the monopoly price from which curve. [2]

2.5 Market shares are 40, 25, 15, 10 and 10 percent. Calculate the four-firm concentration ratio and one limitation of the measure. [3]

3 Exam-style questions

3.1 *(Original.)* On AR $P = 70 - Q/2$, MR $P = 70 - Q$, MC $P = 10 + Q/2$ with ATC 30 at the profit-maximising output: find the output and price, calculate the supernormal profit, and find the deadweight loss against the competitive outcome. [5]

3.2 *(Original.)* A rail network has falling average costs over the whole market. Explain why fragmenting it would raise costs, and evaluate one regulatory response. [3]

3.3 *(Original.)* A bank's deposit insurance leads banks to lend more recklessly. Name the failure and one policy that limits it. [2]