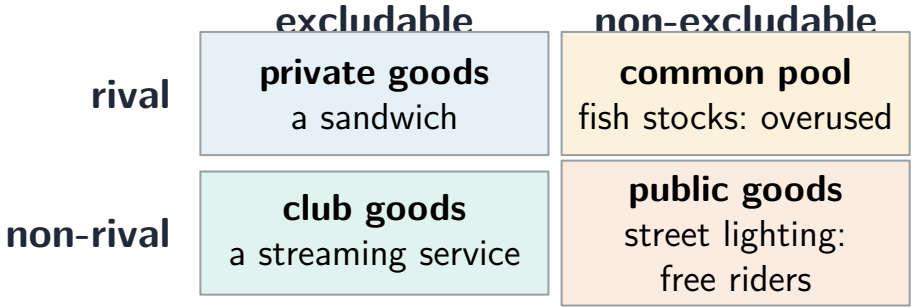
Exercise walk-through

3.3
Asymmetric information and market power

International Baccalaureate · IB Diploma · Economics · SL

Figure: Market failure and equity



non-rival + non-excludable → free-rider problem → the market under-provides or provides none

- Classify goods by rivalry and excludability.
- Match each part of the diagram to the text.

Data-response practice (Paper 2 style) (2)

- (d) Calculate the cost to Firm K of each way to cover its extra 0.2 million tonnes, and state which it will choose. [2]
- (e) Using information from the text and your knowledge of economics, evaluate the use of tradable permits, compared with a **carbon tax** , to reduce carbon emissions. [15]
- **Certainty of quantity.** A permit scheme fixes the total emissions (the cap), and the market finds the price. A **carbon tax** fixes the price, and the quantity is uncertain, because the government does not know how strongly firms will respond. For a climate target in tonnes, the cap is the more direct tool.

Check yourself

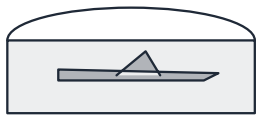
- 1.
- Give one example each of a negative production **externality** and a positive consumption externality. 2.
- On the model with an external cost of 6, the market produces 100 units but the **social optimum** is 92.
- Explain why producing the extra 8 units causes a **welfare loss**, and say where it lies on the diagram. 3.

Exercises 2.1·2.2

2.1 Distinguish between adverse selection and moral hazard. [2]



2.2 Outline **two** barriers to entry in the market for passenger aircraft. [2]



Exercises 2.1·2.2

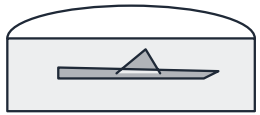
2.1 Distinguish between adverse selection and moral hazard. [2]



2.1

adverse selection happens before a transaction, when one side uses hidden information, e.g. a seller hides faults; moral hazard happens after an agreement, when one side takes more risks because it does not bear the full cost, e.g. an insured driver drives carelessly

2.2 Outline **two** barriers to entry in the market for passenger aircraft. [2]



2.2

any two: huge start-up / research costs; economies of scale of existing firms; patents and technical expertise; safety certification rules; long-standing customer relationships and brand reputation

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Exercise 2.3

2.3 Explain **two** ways in which buyers and sellers of used cars can reduce the problem of asymmetric information. [4]



Exercise 2.3

2.3 Explain **two** ways in which buyers and sellers of used cars can reduce the problem of asymmetric information. [4]



2.3

signalling: the seller offers a warranty / full service history to show the car is good; screening: the buyer pays for an independent inspection / checks the car's history online; government: laws requiring honest descriptions, licensed dealers

Exercise 3.1 (a)

3.1 Two mobile phone networks control most of a country's market and plan to merge.

(a) Identify **one** feature of an oligopoly in this case. [2]

Exercise 3.1 (a)

3.1 Two mobile phone networks control most of a country's market and plan to merge.

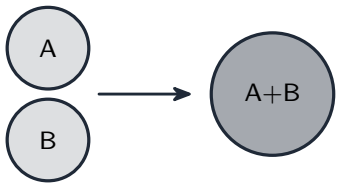
(a) Identify **one** feature of an oligopoly in this case. [2]

(a) a few large firms dominate the market / high barriers to entry (licences, networks) / interdependence

Exercise 3.1 (b)

3.1 Two mobile phone networks control most of a country's market and plan to merge.

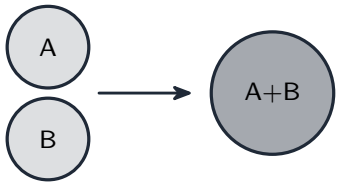
(b) Evaluate a government decision to block the merger. [6]



Exercise 3.1 (b)

3.1 Two mobile phone networks control most of a country's market and plan to merge.

(b) Evaluate a government decision to block the merger. [6]



(b) a merged firm would have near-monopoly power; it could raise prices and cut output, giving allocative inefficiency and a welfare loss for consumers; less incentive to improve quality or innovate; but a larger firm may gain economies of scale, lowering average costs; and may have more funds for investment, e.g. 5G networks; judgement: block, or allow with conditions such as price caps or selling some assets