## Solutions

Marking: **M1** a correct method, **A1** the correct answer, **B1** an independent mark.

Each answer shows the steps, then the **result**.

**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**

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

**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

**3.1**

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

(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



exercises.lol exercises.com.cn