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1.14 ASYMMETRIC INFORMATION AND MONOPOLY POWER HL: STUDENT LEARNING ACTIVITY

Answer the questions that follow.

1. DEFINITIONS

Define the following terms:

[10 marks]

- Asymmetric information
- Benefit
- Consumer surplus
- Free market equilibrium
- Marginal private benefit
- Market equilibrium
- Market failure
- Market power
- Misallocation of resources
- Monopolist
- Monopoly power
- Nationalisation
- Producer revenue
- Producer surplus
- Quantity supplied
- Resources
- Social optimum equilibrium
- Trade liberalisation

2. SHORT-ANSWER QUESTIONS

1. Use examples to explain how a lack of information can result in market failure. **[10 marks]**
2. Information asymmetries can arise in a market where buyers have more information than sellers:
 - i. Provide **two** examples of such information asymmetries
 - ii. Explain how the market fails in each of your examples in (i.) above.
 - iii. Explain how intervention into each market in i. above by the government could correct for the market failure.
 - iv. Explain the advantages and disadvantages of such intervention in (iii.) above. **[20 marks]**
3. Information asymmetries can arise in a market where sellers have more information than buyers:
 - i. Provide **two** examples of such information asymmetries
 - ii. Explain how the market fails in each of your examples in (i.) above.
 - iii. Explain how intervention into each market in i. above by the government could correct for the market failure.
 - iv. Explain the advantages and disadvantages of such intervention in (iii.) above. **[20 marks]**
4. Use a diagram to explain how the abuse of monopoly power is unlikely to be desirable from a social welfare perspective. **[5 marks]**
5. Explain how a firm abusing its monopoly power in a market results in market failure, and how resources are misallocated in such instances. **[5 marks]**
6. Evaluate policies that are available to governments to correct for the market failure caused by monopoly power being abused. **[8 marks]**

3. MULTICHOICE QUESTIONS

Choose the best answer to each question.

[17 marks]

1. Market failure caused by asymmetric information cannot be corrected by governments through:
 - a. Taxes
 - b. Legislation
 - c. Regulation
 - d. Provision of information

2. Which is not a policy to correct a market failure caused by the abuse of monopoly power?
 - a. Nationalisation
 - b. Regulation
 - c. Direct provision
 - d. Trade liberalisation

3. To maximise profits a monopoly firm will:
 - a. Decrease quantity supplied
 - b. Mark up its prices
 - c. Increase quantity supplied
 - d. Increase or decrease prices depending on PE of demand

4. The term used when a seller has more information in a market than the buyer is:
 - a. Price discrimination
 - b. Market segmentation
 - c. Perfect knowledge
 - d. Asymmetric information

5. A key feature of a natural monopoly is that:
 - a. One firm can supply the market more efficiently than two or more firms
 - b. It will be state owned
 - c. It must always produce where $P = MC$
 - d. It will always earn a supernormal profit

6. In which market is the seller least likely to have more information than the buyer?
 - a. Medical services
 - b. The health insurance market
 - c. The used car market
 - d. The market for legal advice

7. Asymmetric information in a market results in:
 - a. Market failure
 - b. Free-riding

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- c. Excess supply
 - d. Excess demand
8. Which market is least likely to have asymmetric information between the buyer and seller?
- a. The used car market
 - b. The market for insurance
 - c. Labour market
 - d. The market for fruit and vegetables
9. Which is not a policy to correct a market failure caused by the abuse of monopoly power?
- a. Legislation
 - b. Regulation
 - c. Direct provision
 - d. Trade liberalisation
10. Market failure caused by asymmetric information cannot be corrected by governments through:
- a. Provision of information
 - b. Regulation
 - c. Subsidies
 - d. Legislation
11. The term used when a buyer has more information in a market than the seller is:
- a. Perfect knowledge
 - b. Asymmetric information
 - c. Market segmentation
 - d. Price discrimination
12. A natural monopoly is a firm whose average cost curve:
- a. Decreases throughout its relevant output range
 - b. Increases throughout its relevant output range
 - c. Is less than its marginal cost curve
 - d. Is subject to diseconomies of scale
13. A government cannot correct for market failure caused by a natural monopoly by:
- a. Regulating marginal cost pricing
 - b. Nationalising the firm
 - c. Providing information to consumers
 - d. Regulating average cost pricing
14. In which market is the buyer least likely to have more information than the seller?
- a. The labour market
 - b. The health insurance market
 - c. The used car market

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d. The market for consumer credit

15. Asymmetric information in the used car market will cause:

- a. A surplus (excess supply)
- b. A shortage (excess demand)
- c. Marginal private benefit > Marginal social benefit
- d. Marginal social benefit > marginal private benefit

16. Which is not a government responses to correct for asymmetric information?

- a. Licensing
- b. Regulation
- c. Providing information to consumers
- d. Nationalisation

17. Which is not a factor in the development of a monopoly?

- a. No close substitutes
- b. A barrier to entry
- c. No close substitutes
- d. Perfect competition

4. TRUE OR FALSE?

Indicate whether the following statements are true or false.

[13 marks]

1. Imperfect information results in market failure

True

False

2. Sellers always have more information than buyers.

True

False

3. $MPB > MSB$ when sellers have more information than buyers.

True

False

4. $MPB < MSB$ when sellers have more information than buyers.

True

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False

5. Governments can intervene with a subsidy to correct asymmetric information market failure.

True

False

6. Governments can intervene with an indirect tax to correct asymmetric information market failure.

True

False

7. Governments can intervene by providing information to correct asymmetric information market failure.

True

False

8. Governments can intervene by regulating quality and safety standards to correct asymmetric information market failure.

True

False

9. Licensing is not an appropriate government intervention to correct for asymmetric information.

True

False

10. Buyers can have more information than sellers.

True

False

11. The insurance market can create a moral hazard for consumers.

True

False

12. The insurance market can reduce the risk of moral hazard for consumers.

True

False

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13. High barriers to entry in an industry can create a monopoly.

True

False

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