

Write your name on the cover of the test booklet and nowhere else. Enclose this sheet with the booklet. Failure to follow these directions will cost you 1 point. The test has 100 points (to be scaled up to 170 points) and is scheduled to take 50 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 14-point question should take 7 minutes. I cannot give extra time because some students have a class after your class.

1) (10 points) Answer EITHER Part A OR Part B.

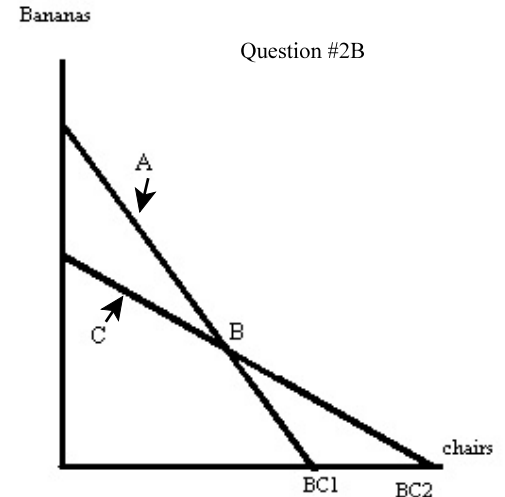
A) Does the snob effect make the demand curve more elastic or less elastic? Explain your logic.

B) Draw the Engel Curve for an inferior good. Briefly explain why it takes that shape.

2) (12 points) Answer EITHER Part A OR Part B.

A) What is the equation which relates marginal revenue to a function of the elasticity? If a good has an inelastic demand, then what does that information tell you about the marginal revenue? Briefly explain your logic.

B) Suppose that when facing budget constraint BC2, you choose Point C. Point B is on both budget lines. Rank Points A, B, and C from lowest utility to highest utility. Briefly explain how you reached your conclusion.



3) (22 points) Answer EITHER Part A OR Part B.

A) Draw a budget constraint/indifference curve diagram for bread and meat which is in equilibrium. Suppose that in the market there is a shortage of bread. The government has two choices. The first choice is to ration bread and the second choice is to let the price of good increase. Show both of these on your graph. Explain how you got those lines. Some people would prefer rationing while others would prefer to let the price go up. Given your graph, which would you prefer? Explain how you reached your conclusion by looking at your graph.

B) Draw budget constraint/indifference curve diagram for renovating Cochran Hall versus renovating Richardson Hall. Suppose that somebody gave a donation which was earmarked for renovating Cochran Hall. Draw the diagram in such a way that the school would have been better off if there had not been an earmark. Explain why the diagram looks as drawn and how you can tell that Bethany would have been better off if there had not been an earmark.

4) (28 points) Answer EITHER Part A OR Part B.

A) Draw the indifference curve/budget constraint diagram which proves the Laspeyres Price Index overestimates the negative impact of inflation on a person. Explain why the lines are drawn as you drew them and explain how the diagram proves the Laspeyres overestimates the impact of inflation.

B) Draw the budget constraint/indifference curve diagram for socks and pants. Draw two more budget constraints which represent decreases in the price of pants. Explain why the curves moved as drawn. Use your graph to draw the demand for pants. Explain how you got the demand curve.

5) (28 points) Answer EITHER Part A OR Part B.

A) Draw an indifference curve/budget constraint diagram for printers versus flashlights. Draw an increase in the price of flashlights. Explain why the curve(s) moved as drawn. Draw a third budget constraint which is necessary to find the income and substitution effects. Find the two effects and explain how you found them. Given your graph, are flashlights and printers substitutes or complements? Are either inferior? Explain your logic.

B) Draw the indifference curve/budget constraint diagram which has potatoes as a Giffen good. You can put potatoes on either axis you want. Draw the third line which shows income and substitution effects. Explain why the curves are where you drew them, how you know that your graph shows potatoes are Giffen goods, and how you found the income and substitution effects.