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 150 points) and is scheduled to take 50 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 12-point question should take 6 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) Is our income tax system progressive, proportional, or regressive? Explain your logic.
B) Suppose inflation is higher than expected this year. For a loan, does this hurt the borrower or the lender? Explain your logic.

2) (12 points) Answer EITHER Part A OR Part B.
A) Some students still do not have the textbook. Use economic terminology to explain why this is the case. (On a personal note, I feel that taking a course without buying the textbook is like buying a car and not buying gas.)
B) When I graded the homework question about the opportunity costs of going to college, I accepted meal plan as an opportunity cost for some students' answers but not for other students' answers. Why is it that in some cases it is an opportunity cost, but at other times it is not? In other words, what determined whether or not I accepted that answer?

3) (12 points) Answer EITHER Part A OR Part B.
A) One of the qualities money needs is to be a *medium of exchange*. Is M1 or M2 a better medium exchange? Explain your logic defining medium of exchange.
B) Define *moral hazard*. Give an example from the insurance industry. (Do <u>not</u> worry about how they reduce the problem.)

4) (14 points) Answer EITHER Part A OR Part B.
A) In the second part of the final, we assume that fiscal policy will affect the economy as desired. *Ricardian Equivalence* says this is not true. Explain what Ricardian Equivalence is and why it <u>may</u> make counter-cyclical (stimulate GDP when it is down and slow GDP when it is up) fiscal policy ineffective.
B) Define *limiting protectionism*. Explain how it helps a country to develop.

5) (16 points) Answer EITHER Part A OR Part B.
A) Draw the PPF for food versus clothing. Illustrate the effects of an increase in the population. Explain why the curve moved as drawn.
B) Draw a PPF for hats versus desks. Explain why it takes its shape.

6) (16 points) Draw the supply and demand for doors. Illustrate the effects of EITHER the event in Part A OR the event in Part B. Explain why the curve(s) moved as drawn. What happens to the price and quantity sold?
A) The door manufacturer gives its workers a pay increase.
B) The price of desks goes up.

7) (20 points) Answer EITHER Part A OR Part B.
A) What is the problem facing Social Security? Some people propose reducing the problem by decreasing the Social Security benefits. How would that reduce the problem? Would you do that as part of your solution? Explain your logic.
B) Draw the supply and demand diagram for a product like gasoline which causes a negative externality. Prove that the market will not provide the optimal quantity of gasoline and the optimal price. What do economists say should be done about it? Illustrate the effects of that policy on the graph. Explain why the curve(s) moved as drawn and show that the new equilibrium is at the optimal point.