

Place your name on the back of this sheet of paper and nowhere else. Staple your answers face up on the front of this sheet of paper. Failure to follow these directions will cost you 1 point. Your assignment will be typed, except graphs can be drawn by hand and mathematical equations can be done by hand. Failure to type it will cost you 10 points. If you use double-sided printing or print on the back of scrap paper, I will give you one additional point.

1) (25 points) When we discussed “enforcement mechanisms,” we talked about “customs.” What is meant by that? Give an example of how that is done. What is a weakness of that enforcement mechanism? Explain your logic.

2) (20 points) *Moral hazard* is a major problem in economies. Explain the problem using the insurance industry as an example. How do insurers reduce the problem? Explain your logic.

3) (20 points) One of the most important terms in this course is *incentives*. Which do you think would help an economy more, *moral incentives* or *material incentives*? Explain your logic and make sure you define both terms.

4) (15 points) According to <http://www.heritage.org/index/heatmap>, all African countries except one have a failing grade for corruption. How does that affect their economy? Explain your logic.

5) (20 points) We said that two goals for the outcomes of an economic system are to have *efficient production* and to have an *equitable distribution of income*. However, improving on one of those outcomes can (and usually does) hurt the other goal. Explain why this might be the case.