

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 10 points. 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) Draw the supply and demand diagram for gasoline which produces a negative externality. Prove that the market will not produce at the socially optimal point. How do economists say is the best way to reduce the problem? Illustrate the effects of that policy on the graph. Explain why your curve(s) moved as drawn and what the new equilibrium is.
- 2) (15 points) What are public goods. Why do they mean we need a government? Explain your logic.
- 3) (15 points) The book lists police as a public good. Why isn't that true? Give two reasons.
- 4) (15 points) The book says that income redistribution is a non-economic reason for government. I argue that it is also an economic reason for government. Explain my logic.
- 5) (15 points) What is the equation for optimality? Why is that correct?
- 6) (15 points) What is meant by monopoly power? Why is that an argument for government?