

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

- A) What is meant by *public goods*? Why is that an argument for government? Explain your logic.
- B) We gave several reasons why fiscal policy might not work. One of them was Ricardian Equivalence. Explain why that may mean that expansionary fiscal policy might not work.

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

- A) Use economic logic and terminology to explain few students are getting an A in this course even though I think you are capable of getting an A.
- B) Use economic logic and terminology to explain why Business professors are typically paid much better than History professors.

3) (14 points) Answer EITHER Part A OR Part B.

- A) Draw a PPF for computers and oil. Illustrate the effects of the discovery of a new oil field. Explain why the curve moved as drawn.
- B) State the *law of comparative advantage*. Does this mean we should restrict trade or move closer to free trade? Explain your logic.

4) (14 points) Answer EITHER Part A OR Part B.

- A) Suppose that you knew how much NI was and you wanted to calculate PI. Name TWO of the pieces of data you would need. Explain how you would use them and why you would use them in that manner.
- B) Suppose that at the beginning of the year the CPI was 500 and people expected inflation of 15%. At the end of the year, the CPI was 550. What was the inflation rate? Show all work. Who was helped by the unexpected change of inflation? Explain your logic.

5) (14 points) Answer EITHER Part A OR Part B.

- A) Collateral reduces both the problems of adverse selection and moral hazard. Define either moral hazard or adverse selection and explain how collateral can reduce it.
- B) I mentioned briefly that there is another category of money called M1Z. It includes all of M1 plus savings accounts and money market accounts, but nothing else from M2. What part of M2 is not in M1Z? Why do you think savings accounts and money market accounts are in M1Z but not the other parts of M2? (Hint: Why do you hold money in M1 rather than in M2?)

6) (16 points) Answer EITHER Part A OR Part B.

- A) Draw the supply and demand diagram for cotton shirts. Illustrate the effects of a drought in the areas which grow cotton. Explain why the curve(s) moved as drawn. What happened to the price of shirts and the quantity sold?
- B) Draw the supply and demand for leather shoes. Illustrate the effects of the price of leather jackets going up. Explain why the curve(s) moved as drawn. What happened to the price of shoes and the quantity sold?

7) (18 points) What is the long-term problem facing Social Security? What are the two long-term trends which are causing this problem? State how they cause that problem. Two of the proposals for reducing the problem are to *raising the retirement age* and *decreasing Social Security benefits*. For ONE of those proposals, how would that help reduce the problem? Would you do that as part of a plan to save Social Security? Explain your logic as to why you would or would not do that.