Name:________________________

Economics 103 Midterm #2
Prof. Bryan Caplan
Spring, 2000

Instructions:

- You have 75 minutes to complete this exam.
- You may use any books, notes, or other materials that you wish, but avoid spending too much time on any one question.
- Partial credit may be awarded on all questions.
- The maximum possible number of points is 100.
- You should have four pages, counting this one.

<u>Part 1:</u> True, False, and Explain
(10 points each - 3 for the right answer, and 7 for the explanation)
State whether each of the following six propositions is true or false. In 2-3 sentences, explain why. *Use S&D diagrams when helpful.*

Questions 1 and 2 refer to the market for snack foods:

S: $Q = -10 + 30P^S$
D: $Q = 200 - 10P^D$

1. T, F, and Explain: **Buyers will pay a higher percentage of any tax in this market than sellers will.**

2. Suppose the government imposes a $1 tax.

T, F, and Explain: **If sellers legally pay the tax, the sticker price on snacks will rise by $.25. If buyers legally pay the tax, the sticker price on snacks will fall by $.25.**

3. Suppose the demand for gasoline is highly elastic but the supply is highly inelastic.

T, F, and Explain: **If the price of crude oil increases, consumers will wind up paying for most of the increase.**

4. T, F, and Explain: **People who rent ultimately benefit little from the large reduction in New York City's murder rate, unless they happen to live in rent-controlled apartments.**

5. A "crime family" employs workers to sell cocaine.

T, F, and Explain: **If the punishment for convicted drug-dealers increases, the wages of the crime family's workers will fall.**

6. Suppose the government bans deductibles on health insurance.

T, F, and Explain: **Landsburg ("Why Taxes Are Bad") would argue that this ban has deadweight costs because it transfers wealth from insurance companies to consumers.**

<u>Part 2:</u> Short Answer
(20 points each)
In 4-6 sentences, answer both of the following questions. *Use a S&D diagram to illustrate each of your answers.*

1. What would happen to the market for low-wage labor if **both** the minimum wage and welfare payments were **increased**? Neatly show both effects on one diagram. Then carefully explain the combined consequences of these policies on wages and employment.

2. The Family Leave Act, passed in Clinton's first term in office, requires employers to give workers three months unpaid leave to care for a new-born infant. What happens in the labor market if wages are permitted to change? What happens if the government makes it illegal to change wages in response to the legislation?