1. The graph below shows the demand and marginal cost curve for miles driven. The demand curve reflects the marginal benefit to the person driving while the marginal cost curve includes gas, wear and tear on the car, etc. For every mile driven, there is an external cost of pollution of 30 cents per mile.

![Graph of Driving Costs]

a. Draw a curve that shows the marginal cost to society of driving. (See the info in the paragraph above.)

b. How many miles of driving would be efficient?

c. If there is no government intervention, how many miles will people choose to drive? Draw the deadweight loss associated with this.

d. If the government were going to put a tax on driving, how much should the tax be to get the efficient outcome?

e. If the government assigned drivers pollution rights to the cleanliness of the air, would we get the efficient outcome? Explain.
2. What are the two characteristics a good must have to be a public good? Give an example of a public good and explain why it fits these characteristics.

3. If a good is a public good, do we expect the private market to provide the efficient amount of the good, too much of the good, or too little of the good? Explain.

4. For each of the following, state which investment would have the higher expected return, ceteris paribus. **Explain.**
   a. a liquid investment compared to an investment that is less liquid
   b. a risky investment compared to an investment that is less risky
   c. a money market or a mutual fund

5. By this time you have a pretty good idea about multiple-choice tests in this class. On the attached sheet I want YOU to write two multiple-choice questions that could be used on the third test or on the final exam for material covered on the third test. Each question should cover material we have discussed since the last midterm. The questions can be on any subject we covered, but cannot be from the old exams that are on my web page. I will read through these questions and the ones that I think are best will appear on the exam. This means you have an incentive to write good questions — if you write good questions, you increase the likelihood your question is on the test and thus that you will get the question correct. (Remember, I don’t really like to use questions that are just definitions — try to make the question apply the material we have learned.) Make sure the question is clear (you know how much you hate confusing questions) and has either 4 or 5 answers listed. Put a star next to the answer that is correct.
Multiple-Choice Question #1

Multiple-Choice Question #2