

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 160 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) (10 points) Answer EITHER Part A OR Part B.

- A) Give an example of cyclical unemployment. Explain why that case is cyclical unemployment.  
 B) Explain how underemployment can cause the unemployment numbers to be misleading.

2) (10 points each) For TWO of the following parts, tell me what happens to GDP. Which part of GDP is affected? Explain your logic.

- A) You buy \$400 worth of stock and pay \$10 in commissions.  
 B) The government pays \$1 billion for a new aircraft carrier.  
 C) I pay \$100 for a new pair of shoes made in Brazil.

3) (12 points) Answer EITHER Part A OR Part B.

- A) Without drawing the graph, explain why a negative externality will result in an output which is not socially optimal.  
 B) Explain why providing a legal system is an economic reason for having a government.

4) (12 points) Answer EITHER Part A OR Part B.

- A) I gave you the following table on a homework assignment. Without doing the calculations, explain how you would find the marginal tax rate and average tax rate for a person earning \$30,000.  
 B) What is the difference between a progressive tax and a regressive tax? Which is the income tax? Explain your logic.

Income bracket	Tax rate
\$0 - \$20,000	0%
\$20,000 - \$45,000	20%
\$45,000 - \$100,000	40%
>\$100,000	50%

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

- A) Suppose the CPI at the beginning of the year was 600 and at the end of the year was 660. How much was the inflation? Show all work. If at the beginning of the year, people had expected 15% inflation, then who is hurt and who is helped by the inflation? Mention two groups of people hurt and two helped and explain how they are helped or hurt.  
 B) Explain how menu costs are a cost of inflation, even when it is fully anticipated.

6) (14 points) Answer EITHER Part A OR Part B.

- A) What is meant by "creative destruction"? How does that help a country to develop?  
 B) Suppose you are saving for retirement. Assume you get a 6% return on your IRA. (If it is in stocks, that is slightly low.) If your annual income is \$50,000.00, you need to have saved up \$1 million to keep your standard of living. If you save for 40 years, you will need to save \$502.14 per month. If you wait 10 years and only save for 30 years, you will need to save \$1,070.05 per month. What are the two economic reasons you need to save more than twice as much? **(Note, this implies you should start saving for retirement today!)**

7) (18 points) Answer EITHER Part A OR Part B.

- A) What is the long-term problem Social Security is facing? What are the two long-term trends which are contributing to it? One proposed solution to the problem, is to "means test" the Social Security benefits. How would that reduce the problem? Would you do that as part of a big plan to fix Social Security? Explain your logic.  
 B) What is the long-term problem Social Security is facing? What are the two long-term trends which are contributing to it? One proposed solution to the problem, is to decrease the Social Security benefits. How would that reduce the problem? Would you do that as part of a big plan to fix Social Security? Explain your logic.