

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 170 points) and is scheduled to take 50 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 16-point question should take 8 minutes. Because of the class that follows your class, I cannot give you extra time.

1) (8 points each) For TWO of the following events, determine if it is part of GDP. If it is, then tell me which part and how you reached that conclusion. If it is not, then tell me why it is not.

- A) You buy a new stock that you expect to take off.
- B) The government pays the President's salary.
- C) You buy a new car from Japan.

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

- A) What is the tax base? Why is it important to know what happens to the tax base when the tax rate changes?
- B) What is underemployment? Why is it important for understanding the unemployment rate?

3) (16 points) Do EITHER Part A OR Part B. Both assume that there are political constraints on the government's action. Therefore, in each case, you are limited to only two options.

- A) If you could **only** solve the problem with Social Security by either raising the rate of the tax or by increasing the age necessary to get Social Security benefits, which would you choose? Explain why you chose that option and why you would not choose the other option.
- B) If you could **only** solve the problem with Social Security by either eliminating the cap on social security or by allowing social security's trust fund to be used to buy stocks and bonds, which would you choose? Explain why you chose that option and why you would not choose the other option.

4) (18 points) Do EITHER Part A OR Part B.

- A) What is the optimal level for the unemployment rate in the USA? Why is that number not zero? Mention the three types of unemployment in your answer.
- B) If the inflation rate is 5%, but we expected it to be 7%, then what two groups of people lose and what two groups of people gain? Explain your logic.

3) (18 points) Do EITHER Part A OR Part B.

- A) Suppose that a person was a homemaker and decided to look for a job. What happens to the unemployment rate and the labor force participation rate? What happens when a working person retires to the unemployment rate and the labor force participation rate? For both people, briefly explain your logic.

B) Use the box on the right to calculate both the labor force participation rate and the unemployment rate. Show all work and give a one-sentence explanation of what you did.

| Classification: | Looking for a job | Employed | Home maker | Discouraged |
|-----------------|-------------------|----------|------------|-------------|
| # of people | 50 | 950 | 800 | 200 |

6) (20points) Do EITHER Part A OR Part B.

- A) What are two of the negative effects of economic growth? Explain why they are a problem.
- B) Why do open economies grow faster? Why is creative destruction important to economic growth?