

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 150 points (to be scaled up to 210 points) and is scheduled to take 75 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) Every statistic has problems with the definition which make it less useful than we would like it to be. What are two problems which make the inflation rate less useful than it should be? Explain your logic.

B) What is wrong with the following statement which is commonly heard? “Higher inflation causes prices to go up. This means people cannot afford to buy as much as they used to buy. That is one of the reasons why high inflation hurts the economy.”

2) (12 points) For EITHER *creative destruction* OR *limit protectionism*, tell me what the phrase means and explain why it is a key to development.

3) (12 points) Answer ONE of the following parts.

A) Explain the difference between real GDP and nominal GDP. Which one is represented by Y?

B) When comparing GDP across countries, why don't we use the exchange rate to convert currencies?

C) Explain how we convert GDP from a European country using the euro to dollars.

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

A) What is the economic reason why raising any tax rate, could in theory reduce the tax revenue? Explain your logic. Provide a numerical example. (Note, the Laffer Curve is not a numerical example.)

B) Suppose a person earns \$100,000. If the tax brackets to the right applied, then what would this person's marginal tax rate, total taxes paid, and average tax rate be? Show all work. If there is no work, then briefly explain how you got the number.

Income	Rate
income $\leq$ \$40,000	15%
\$40,000 < income $\leq$ \$70,000	20%
\$70,000 < income $\leq$ \$90,000	25%
\$90,000 < income $\leq$ \$150,000	30%
income > \$150,000	50%

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

A) When President Obama was running for re-election, he said, “If there is anybody who wants a job but cannot find a job, then I have not done my job.” In other words, “If the unemployment rate is not 0%, then I have not done my job.” Explain why it is impossible for any President to have done their job if that is how we define “doing their job.” What unemployment rate do economists feel will signify that we are at full employment in the USA?

B) Suppose that at the beginning of the year, the CPI was 1000 and people expected 5% inflation. At the end of the year, the CPI was 1030. What was the inflation rate? Show all work. Name one group of people hurt by the actual inflation. Briefly explain why they are hurt.

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

A) As the example on the review sheet showed, if you wait 10 years to start saving for retirement, you have to save about twice as much as if you did not wait 10 years. What are the two economic reasons for this?

Explain your logic.

B) Where you put your money for retirement matters. According to CNN/Money, since 1928, the average return on stocks has been 10% per year while long-term US Government bonds have averaged a 5% - 6% return. How long would it take your money to double if you earned 10%? How long does it take for 5% to double? Show all work and briefly explain what you are doing. What is the disadvantage of putting your retirement money in stocks? [http://money.cnn.com/retirement/guide/investing\\_bonds.money.com/index3.htm](http://money.cnn.com/retirement/guide/investing_bonds.money.com/index3.htm)

7) (16 points) Answer EITHER Part A OR Part B.

A) Suppose the consumption function is given by  $C = 1000 + .8(Y-T)$ . Find the MPC, MPS, APC, and APS for a person who earns \$10,000. Show all work and if there is no work, then state how you found the answer.

B) For BOTH my purchase of a \$50 shirt which the store bought from the country Jordan for \$30 AND your purchase of \$1000 worth of Ford stock while paying \$10 in commissions, tell me how much GDP changed, which part of GDP changed, and how you reached your conclusions.

8) (18 points) Answer EITHER Part A OR Part B.

A) What is the problem facing Social Security? What are the two trends which mean the problem will get worse for at least two decades? One proposal to solving the problem is to *means test* benefits. How would that reduce the problem? Explain your logic. Would you include this as part of a plan to solve the problem? Explain your logic.

B) What is the problem facing Social Security? What are the two trends which mean the problem will get worse for at least two decades? One proposal to solving the problem is to increase the Social Security tax. How would that reduce the problem? Explain your logic. Would you include this as part of a plan to solve the problem? Explain your logic.

9) (18 points) There are four types of unemployment. Name THREE of them. For TWO of those, give an example and explain why it fits that category.

10) (20 points) Draw the Keynesian Cross, a.k.a.  $45^\circ$  diagram. Illustrate the effects of EITHER the event in Part A OR the effects of the event in Part B. Explain why the curve(s) moved as drawn. What happens to the equilibrium level of GDP?

A) The government spends less. (I realize it is not very realistic, but do it anyhow.)

B) Interest rates go down.