

Sample Midterm#2

Part I – Multiple Choice Questions

1. B
2. D
3. B
4. C
5. D
6. A
7. B
8. C
9. D
10. A
11. B
12. A
13. D

Part II – Calculations and Explanations

Note: calculate your answers and provide your explanations concisely. Write down the formulas you are trying to use whenever necessary.

14. public saving= $2500-2000=500$, government has a surplus;
Private saving= $11000-2500-7500=1000$
National saving= $500+1000=1500$.
Investment= 1500 .

15. This table shows the 2003 data for males and females ages 16 and over in the imaginary country of Meditor.

1. Not in labor force
 - a. male: 45 million
 - b. female: 35 million
2. Unemployed
 - a. male: 5 million
 - b. female: 5 million
3. Employed
 - a. male: 85 million
 - b. female: 65 million

(a) What is the total adult population and the total adult labor force in Meditor?

ANS

Total adult population = Not in labor force + Unemployed+ Employed = 240 million

Total adult labor force = Unemployed+ Employed = 160 million

(b) What is the adult unemployment rate and adult labor-force participation rate in Meditor?

ANS

Unemployment rate = % of labor force that is unemployed

$$= 100 \times \frac{\text{\# of unemployed}}{\text{labor force}} = 100 \times \frac{10}{160} = 6.25\%$$

Labor force participation rate = % of adult population that is in the labor force

$$= 100 \times \frac{\text{labor force}}{\text{adult population}} = 100 \times \frac{160}{240} = 66.67\%$$

16. You have been saving up to buy the Godot Company. The total cost will be \$10 million. You currently have about \$2.3 million.

(a) If you can earn 5% on your money how long will you have to wait?

ANS

At 5% , you will have to wait

$$\$2.3\text{million} = \frac{\$10\text{million}}{(1+.05)^n}$$

$$1.05^n = 4.35$$

$$n = 30 \text{ years}$$

(b) How long will you have to wait at 16% ?

ANS

At 16% you will have to wait

$$\$2.3\text{million} = \frac{\$10\text{million}}{(1+.16)^n}$$

$$1.16^n = 4.35$$

$$n = 10 \text{ years}$$

17.

Country	Adult Population	Labor Force	Employed	Unemployed	Unemployment	Labor-Force Participation Rate
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					Rate	
Japan	109,474	66,010	62,510	3,500	5.30	60.30
France	46,804	26,870	24,293	2,577	9.59	57.41
Germany	70,159	39,591	35,755	3,836	9.69	56.43

Part III – Essay Questions

Note: Provide your answers and explain them as clearly as possible. A clear logic in your analysis will be highly appreciated. Try to write down the theoretical framework and start your analysis even if you are not sure about the answer. Diagrams are always helpful.

18. Give two conditions that are important to the efficient market theory. List one implication of the efficient market theory.

ANS:

Efficient market theory says that it should be very difficult to beat the market by finding undervalued stocks. The first condition is that lots of people are following the stock exchange closely, so that any new information will be quickly reflected in a change in the stock price. The second condition is that supply and demand determine the price. Thus, the market will balance the number of people who think the stock is overvalued with those who think it is undervalued. Consequently, it should be difficult to consistently beat the market.

19. Teenage unemployment is higher than unemployment of people ages 20 and over. Explain why economists would attribute at least part of this difference to minimum-wage laws. (Hint: who is likely to get paid more?)

ANS:

People who are experienced and educated are likely to find jobs where the equilibrium wage is above the minimum wage. In labor markets where the equilibrium wage is above the minimum wage, the minimum wage does not create unemployment. Since people ages 20 and over tend to have more experience and education than younger persons, the minimum wage matters less and so creates less unemployment.

20. What is the theory of efficiency wages? Provide two reasons that employers might pay efficiency wages.

ANS:

According to the theory of efficiency wages, firms operate more efficiently if wages are above the equilibrium level. Therefore, it may be profitable for firms to keep wages high

even in the presence of an excess supply of labor. If so, firms will keep wages above the equilibrium level, creating unemployment.

(1) Worker Health:

Better-paid workers eat a more nutritious diet, and workers who eat a better diet are healthier and more productive. A firm may find it profitable to pay higher wages in order to have healthier, more productive workers.

(2) Worker Turnover:

The more a firm pays its workers, the less often its workers choose to leave the firm. Since it is costly to hire and train new workers, it may be profitable for an employer to pay higher than equilibrium wages in order to reduce worker turnover rates.

(3) Worker Effort

In jobs where workers have some discretion over how hard they work, workers may shirk. As a result, firms monitor the effort of their workers, and those caught shirking are fired. However, it is costly to monitor workers, and monitoring is often imperfect. By paying higher wages, firms make it more expensive for workers to shirk, since if they are caught they will not readily find other employment at their current wage. It may be profitable for a firm to pay higher than market wages in order to reduce shirking.

(4) Worker Quality

When a firm hires new workers, it cannot perfectly gauge the quality of the applicants. By paying a higher wage, the firm attracts a better pool of workers to apply for its jobs. It may be profitable for a firm to pay higher than market wages in order to increase the probability that it will hire good-quality workers.