Economics 1B
Davis Honors Challenge Section
November 8, 1999

My name__________________

QUIZ

Answer all three questions on these sheets, for a total of 30 points. Total time = 30 minutes.

(1.) (10 points = 10 minutes.) Why should the unemployment rate and the government budget deficit as a share of GDP be correlated with each other? Does higher unemployment cause a higher deficit, or does the higher deficit cause the higher unemployment? Explain.

(2.) (6 points = 6 minutes.) Why do states (of the United States) usually balance their budgets but the federal government does not? Explain.

(3.) (14 points = 14 minutes.) Suppose that a government is considering a new payroll tax, where employers have to pay the government an extra 10% on top of the wages they pay. Assume that the government gives the tax revenues back to the whole population, as a fixed amount per person. Suppose further that the tax has these effects on job markets:

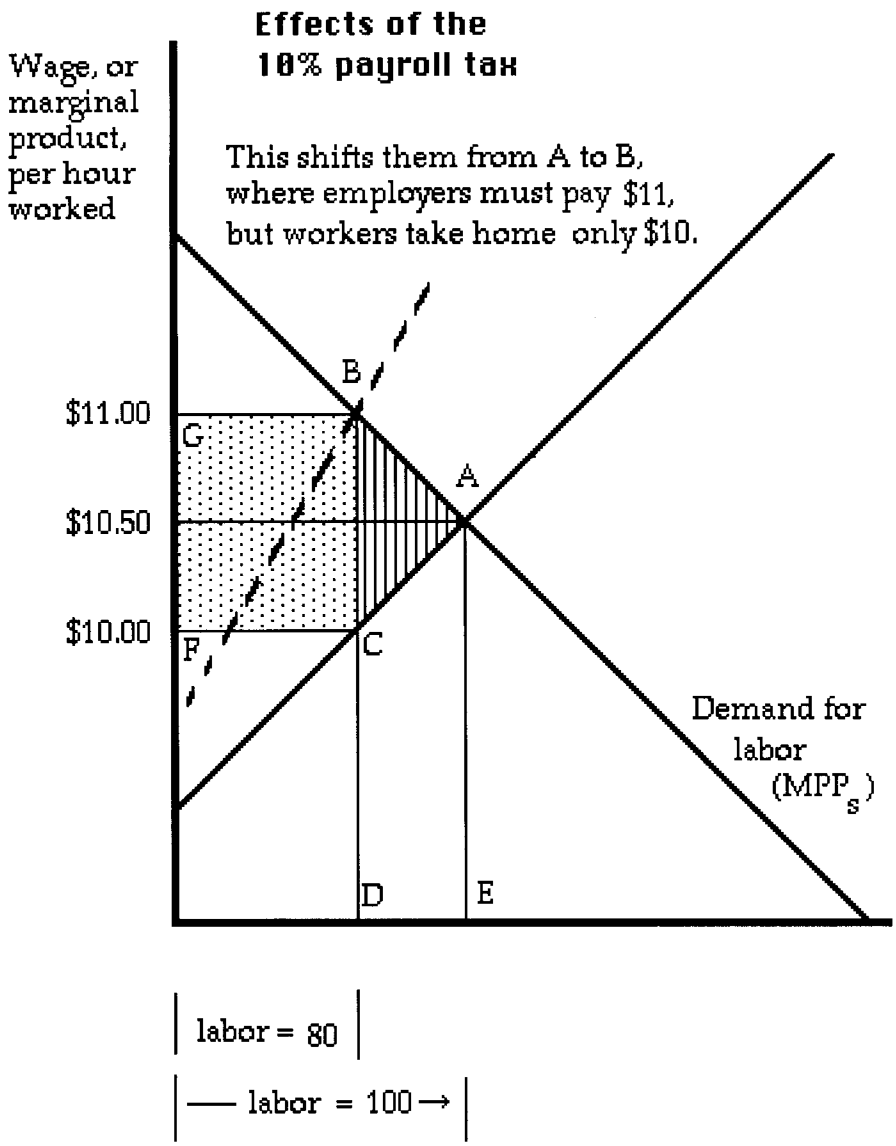
	With <u>no</u> <u>payroll tax</u>	With a 10% <u>payroll tax</u>
(a) Quantity of employ't (mill. hrs.)	100	80
(b) Wage/hour received by workers	$10.50	$10
(c) Total payroll = (a) times (b)	$1050 million	$800 million
(d) Tax revenue = 10% of (c)	zero	$ 80 million

(3a) (4 points) Is this a gain of a loss for the employers of labor? For the workers? Explain.

(3b) (5 points) Is the government tax revenue of $80 million a gain or a loss, or neither, for society as a whole? Explain.

(3c) (5 points) What is the net overall ("deadweight") loss or gain for society as a whole? Explain as specifically as your can.

[See the diagram on the next page for the answer in terms of numbers.]



Payroll tax revenue = BCFG = $ 80 million.

Output (GDP) lost = ABDE = $ 215 million.

Value of leisure time gained = ACDE = $205 million.

Deadweight welfare loss, taking account of the value of leisure time = ABC = $10 million.