

CHAPTER 4

The U.S. Economy: Private and Public Sectors

1. The personal distribution of income refers to the:
 - A) division of income between personal taxes, consumption expenditures, and saving.
 - B) division of income on the basis of industry sources, for example, agriculture, transportation, and mining.
 - C) distribution of income to basic resource classes, that is, wages, rents, interest, and profits.
 - D) way income is distributed among specific households or spending units.

6. The largest functional share of the national income consists of:
 - A) wages and salaries.
 - B) interest and rental income.
 - C) proprietors' income, that is, the income of unincorporated businesses.
 - D) corporate profits.

14. Since 1940 personal taxes have:
- A) risen absolutely, but declined as a percentage of personal income.
 - B) risen both absolutely and as a percentage of personal income.
 - C) fallen absolutely, but risen as a percentage of personal income.
 - D) fallen both absolutely and as a percentage of personal income.
15. Listed in descending order of relative size, total consumption spending is comprised of:
- A) nondurable goods, durable goods, and services.
 - B) services, nondurable goods, and durable goods.
 - C) services, durable goods, and nondurable goods.
 - D) durable goods, nondurable goods, and services.
17. Economists define saving as:
- A) that part of after-tax income which is not consumed.
 - B) total income less taxes.
 - C) bank accounts.
 - D) purchases of stocks and bonds.
18. Households in the aggregate use the largest share of their total income to:
- A) pay taxes. B) consume. C) save. D) buy capital goods.
19. What unusual event happened to U.S. households in 2005?
- A) Total payments of personal taxes exceeded consumption expenditures.
 - B) Personal saving exceeded personal taxes.
 - C) The rate of personal saving was negative.
 - D) Households allocated equal percentages of their incomes to consumption, personal taxes, and personal saving.
20. Economists define durable goods as those products expected to last at least _____ year(s).
- A) 1 B) 3 C) 5 D) 10
21. The majority of personal consumption expenditures go to purchase:
- A) nondurable goods. B) durable goods. C) capital goods. D) services.

25. An industry is best defined as a group of firms that:
- A) compete for labor.
 - B) produce identical or similar products.
 - C) use identical production techniques.
 - D) are located in the same city or geographic area.
26. A firm that makes computer chips at several locations across the country best illustrates a:
- A) vertically integrated firm.
 - B) multinational corporation.
 - C) multiplant firm.
 - D) conglomerate.
27. A firm that produces a single product but owns plants in many different stages of the production process—for example, a steel producer that owns iron ore mines and rolling mills—best illustrates a:
- A) vertically integrated firm.
 - B) multinational corporation.
 - C) virtual corporation.
 - D) conglomerate.
28. A firm comprised of plants or units operating in different industries, say, beer and theme parks, best illustrates a:
- A) vertically integrated firm.
 - B) multinational corporation.
 - C) multiplant firm.
 - D) conglomerate.
29. A group of plants that is owned and operated by a single firm and that consists of oil fields, refineries, and gasoline stations best illustrates a:
- A) trust.
 - B) holding company.
 - C) vertically integrated firm.
 - D) multinational corporation.
33. The three basic legal forms of business enterprise are:
- A) monopolists, competitors, and enterprises.
 - B) proprietorships, partnerships, and corporations.
 - C) vertical, horizontal, and conglomerate corporations.
 - D) conglomerates, multinationals, and partnerships.
35. The advantages of the corporate form of business include:
- A) the ability to raise financial capital by selling stocks and bonds.
 - B) the fact that owners are subject to unlimited liability.
 - C) the elimination of the principal-agent problem.
 - D) single taxation of corporate earnings.

37. The most crucial determinant of the legal form of an enterprise will usually be the:
- A) ability of the firm to sell bonds to the public.
 - B) amount of financial capital required by the line of production.
 - C) amount of unemployment in the particular industry.
 - D) state in which it is located.
39. An owner's liability for the debts of a business is:
- A) limited in a corporation to the assets of preferred stockholders.
 - B) limited in a corporation to the assets of bondholders.
 - C) limited to the owner's investment in a single proprietorship.
 - D) unlimited in a partnership.
41. Limited liability applies to:
- A) partnerships.
 - B) proprietorships.
 - C) all corporations.
 - D) financial corporations but not to manufacturing corporations.
43. The separation of ownership and control in a corporation means that:
- A) hired managers play a larger role in determining company policy than do a corporation's legal owners.
 - B) the ownership of corporations is becoming increasingly concentrated in the hands of a few common stockholders.
 - C) a firm's board of directors has no power over hired managers.
 - D) stockholders have lost their voting privileges.
44. Limited liability means that:
- A) creditors have no legal claim on the personal assets of a proprietor.
 - B) corporations cannot be sued.
 - C) creditors have no legal claim on the personal assets of a corporate stockholder.
 - D) corporations have a legal life independent of their owners and managers.
45. Stocks are:
- A) promises to repay a loan.
 - B) also known as bonds.
 - C) issued by sole proprietorships.
 - D) shares of ownership of a corporation.
46. Corporate bonds are:
- A) promises by a corporation to repay a loan.
 - B) also known as stocks.
 - C) illegal in the United States.
 - D) shares of ownership of a corporation.

48. In corporations, owners are _____ and managers are _____.
- A) agents; principals.
 - B) stockholders; bondholders.
 - C) agents; employees.
 - D) principals; agents.
50. Most output in the United States is produced by:
- A) cooperatives.
 - B) partnerships.
 - C) sole proprietorships.
 - D) corporations.
58. In a competitive market:
- A) demand will not always reflect all external benefits.
 - B) demand will always reflect all external benefits.
 - C) supply will always reflect all external costs.
 - D) supply will always reflect all external benefits.
60. Negative externalities arise:
- A) when firms pay more than the opportunity cost of resources.
 - B) when the demand curve for a product is located too far to the left.
 - C) when firms "use" resources without being compelled to pay for their full costs.
 - D) only in capitalistic societies.
61. Positive externalities benefits
- A) benefits that accrue to parties other than the producer and buyer of a good.
 - B) the benefits that resource suppliers obtain from the production and sale of a good.
 - C) the benefit that a consumer receives from buying a good.
 - D) the combined benefits that buyer and seller receive from a voluntary market transaction.
64. When externalities cause substantial positive benefits for third parties, a competitive market:
- A) underallocates resources to the production of the good.
 - B) overallocates resources to the production of the good.
 - C) is allocatively efficient.
 - D) compensates people for the value of the benefits that these third parties receive.
72. Suppose a product creates substantial negative externalities. If government adopts a policy that forces producers to pay these costs, the:
- A) output of the product will decrease.
 - B) initial misallocation of resources will be intensified.
 - C) output of the product will increase.
 - D) price of the product will decrease.

73. If negative externalities are not internalized, the:
- A) equilibrium output will exceed the most efficient output.
 - B) most efficient output will exceed the equilibrium output.
 - C) product must be a public good.
 - D) distribution of income will necessarily become more equal.
79. A market externality refers to:
- A) economic costs and benefits of market activities that go to those who are not directly involved in the market transaction.
 - B) the impact of legal and institutional forces on market behavior.
 - C) any unanticipated change in market price or output.
 - D) any noneconomic force, for example, political disruption of the flow of Middle East oil, which has market effects.
81. A subsidy:
- A) should be provided when there are external costs.
 - B) should be provided when there are external benefits.
 - C) should be provided only when a public good is being produced.
 - D) is appropriate when firms are guilty of pollution.
82. If an industry creates externalities so that resources are overallocated to the industry:
- A) a principal-agent problem must be present.
 - B) the industry is producing a public good.
 - C) external costs are involved.
 - D) external benefits are involved.
83. If the production and consumption of a good cause both positive and negative externalities:
- A) the equilibrium output will be the optimal allocation of resources to its production.
 - B) resources will necessarily be underallocated to its production.
 - C) resources will necessarily be overallocated to its production.
 - D) resources may be either underallocated or overallocated to its production.
84. Education levels and crime rates are inversely related. This suggests that education:
- A) is not subject to the exclusion principle.
 - B) entails external benefits.
 - C) creates a free-rider problem.
 - D) should be produced in the private sector.
85. Which of the following could be used to correct for a positive externality?
- A) A subsidy to consumers of the good.
 - B) A subsidy to producers of the good.
 - C) Provision of the good by government.
 - D) All of the above are ways to correct for a positive externality.

Public goods

86. The main characteristics of a public good are:
A) nonrivalry and nonexcludability.
B) nonexcludability and rising costs of production.
C) nonrivalry and large external costs.
D) production at constant cost and rising demand.
89. Rivalry and excludability are the main characteristics of:
A) capital goods. B) private goods. C) public goods. D) consumption goods.
90. Nonrivalry and nonexcludability are the main characteristics of:
A) capital goods. B) private goods. C) public goods. D) consumption goods.
92. Which of the following is an example of a public good?
A) a fireworks display. B) a hotdog C) a barbeque grill D) a personal computer
94. Which of the following is a public good?
A) chewing gum B) bread C) a professional baseball game D) street lights in a city
95. A public good:
A) can be produced profitably by private firms.
B) is available to all and cannot be denied to anyone.
C) is characterized by rivalry and excludability.
D) produces no externalities.
96. The market system does not produce public goods because:
A) there is no need or demand for such goods.
B) private firms cannot stop consumers who are unwilling to pay for such goods from benefiting from them.
C) public enterprises can produce such goods at lower cost than can private enterprises.
D) their production seriously distorts the distribution of income.

97. Nonexcludability is the idea that:
- A) government actions cannot remedy market failure.
 - B) the presence of external costs and benefits produces a misallocation of resources.
 - C) individuals cannot receive benefits from a good without paying for it.
 - D) individuals who are unable or unwilling to pay for a good cannot be excluded from the benefits provided by that product.
98. Excludability:
- A) is a characteristics of private goods, but not of public goods.
 - B) applies only where external benefits exceed external costs.
 - C) suggest there are certain economic functions from which government must be excluded.
 - D) is a fundamental characteristic of public goods.
101. Government rather than the private sector must provide economically desirable public goods because:
- A) private production of those goods would entail unacceptably high external costs.
 - B) the availability of such goods yields no benefits to individuals.
 - C) the benefits yielded by such goods are available to everyone and cannot be withheld from those who refuse to pay for them.
 - D) their provision is necessary to achieve full employment and price-level stability.
103. The free-rider problem is that:
- A) free public transportation is overcrowded.
 - B) people will not voluntarily pay for something that they can obtain without paying.
 - C) government supplies goods at no charge to people who can afford to pay for them.
 - D) public goods often create large external costs.
104. Government rather than private firms must provide economically desirable public goods because:
- A) high marginal costs preclude their production in the private sector.
 - B) public goods have characteristics that make it difficult or impossible for private firms to produce them profitably.
 - C) public goods have marginal costs that exceed marginal benefits.
 - D) the law of increasing opportunity costs applies only to private goods.

105. A quasi-public good is:
- A) a public good that is produced profitably by private firms, without government subsidy.
 - B) one characterized by nonrivalry and nonexcludability.
 - C) one characterized by rivalry but not excludability.
 - D) a good for which exclusion could take place but that has such large spillover benefits that government provides it to prevent an underallocation of resources.
109. The public decision to build the interstate highway system is an example of:
- A) the allocative function of government.
 - B) the redistributive function of government.
 - C) public provision of a suitable legal framework for the market system.
 - D) the stabilization function of government.
110. In a full-employment economy government can reallocate resources from private to public employment by:
- A) reducing taxes and increasing government expenditures.
 - B) reducing taxes and reducing government expenditures.
 - C) increasing taxes and reducing government expenditures.
 - D) increasing taxes and increasing government expenditures.

Stabilization

115. The stabilization function of government involves government's efforts to:
- A) alter the output of specific goods when external costs or benefits are present.
 - B) reduce the after-tax incomes of the rich and increase the after-tax incomes of the poor.
 - C) deal with the problems of substantial unemployment and rapid inflation.
 - D) provide the socially desired output of public goods.
121. Government's economic role is complicated by the fact that:
- A) public goods entail no opportunity costs.
 - B) the public sector cannot base decisions on marginal costs and marginal benefits.
 - C) economic decisions are made in a political context.
 - D) the marginal utility of public goods rises rather than falls.

Purchases, transfers, and government size

133. In 2006, "Tax-Freedom Day" (the day average workers have earned enough to pay their tax bills) was:
- A) February 10.
 - B) April 15.
 - C) April 26.
 - D) July 7.
140. Government transfer payments:
- A) have been virtually eliminated by Federal revenue sharing.
 - B) have virtually no effect on the distribution of income.
 - C) make the distribution of income less equal.
 - D) make the distribution of income less unequal.
144. The three most important sources of Federal tax revenue in order of descending importance are:
- A) sales, payroll, and personal income taxes.
 - B) personal income, corporate income, and sales taxes.
 - C) personal income, corporate income, and payroll taxes.
 - D) personal income, payroll, and corporate income taxes.
146. The largest category of Federal spending is for:
- A) agriculture and rural development.
 - B) science, space, and technology.
 - C) pensions and income security.
 - D) highway construction.

149. Which of the following is *not* an important source of revenue for the Federal government?
A) corporate income taxes B) property taxes C) payroll taxes D) personal income taxes
151. An income tax is progressive if the:
A) absolute amount paid as taxes varies directly with income.
B) percentage of income paid as taxes is the same regardless of the size of income.
C) percentage of income paid as taxes increases as income increases.
D) tax rate varies inversely with income.
154. The marginal tax rate is:
A) the difference between the total tax rate and the average tax rate.
B) the percentage of total income paid as taxes.
C) $\text{change in taxes} / \text{change in taxable income}$
D) $\text{total taxes} / \text{total taxable income}$
155. The average tax rate is:
A) $\text{change in taxes} / \text{change in taxable income}$
B) $\text{total taxes} / \text{total taxable income}$
C) the sum of the marginal tax rate and the rate of transfer payments.
D) the tax on incremental income less the tax on total income.
167. The most important source of Federal tax revenue is:
A) sales taxes. B) personal income taxes. C) corporate income taxes. D) payroll taxes.
168. Taxable income is:
A) total income less deductions and exemptions.
B) only income to which marginal tax rates apply.
C) the same as gross income.
D) the sum of all wage and property income.
169. The basic tax rate on taxable corporate income is:
A) 15 percent. B) 22 percent. C) 35 percent. D) 52 percent.

True/False Questions

182. Only the bondholders of a corporation have the right to vote for a corporation's directors.
183. Limited liability means all members of a partnership are liable for the debts incurred by one another.
184. A vertically integrated firm is a group of plants each operating at different stages of production.
185. Households spend a larger proportion of their incomes for services than for either nondurable goods or durable goods.
188. When there are negative externalities involved in the production of a good, fewer resources are allocated to its production than if all costs were internalized.
189. If a good's production creates substantial negative externalities, then too little of it will be produced unless firms are subsidized.
192. The free-rider problem refers to the possibility that someone may benefit from a good without paying for it.
193. The misallocation of resources resulting from large positive externalities can best be corrected by levying a specific tax on the production of that good or service.
194. Public goods are characterized by nonrivalry and nonexcludability.
195. As it relates to public goods, nonexcludability means that nonpayers cannot be barred from obtaining the benefits.
198. Government assumes some responsibility for providing a minimum standard of living for all citizens to compensate for the increase in income inequality caused by government tax revenues and expenditures.
200. The largest source of local government's revenue is the sales tax.