1. Refer to the above diagram, in which solid arrows reflect real flows; broken arrows are monetary flows. Flow (8) might represent:
A. personal income taxes.
B. automobile purchases by the state of Maine.
C. the services of firefighters.
D. subsidies to farmers.

2. 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.

The following data represent a personal income tax schedule. Answer the next question(s) on the basis of this information.

<table>
<thead>
<tr>
<th>Taxable Income</th>
<th>Total Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ 0</td>
<td>$ 0</td>
</tr>
<tr>
<td>2000</td>
<td>200</td>
</tr>
<tr>
<td>4000</td>
<td>600</td>
</tr>
<tr>
<td>6000</td>
<td>1200</td>
</tr>
<tr>
<td>8000</td>
<td>2000</td>
</tr>
<tr>
<td>10,000</td>
<td>3000</td>
</tr>
</tbody>
</table>
3. Refer to the above table. If your taxable income is $8,000, your average tax rate is:
   A. 25 percent and the marginal rate on additional income is also 25 percent.
   B. 25 percent and the marginal rate on additional income is 50 percent.
   C. 25 percent and the marginal rate on additional income cannot be determined from the information given.
   D. 20 percent and the marginal rate on additional income is 30 percent.

4. For a progressive tax the:
   A. average tax rate exceeds the marginal tax rate as income rises.
   B. marginal tax rate declines as income increases.
   C. average and marginal tax rates are equal.
   D. marginal tax rate exceeds the average tax rate as income rises.

5. 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.

6. Externalities:
   A. relate to costs only.
   B. relate to benefits only.
   C. relate to both costs and benefits.
   D. have been legislated out of existence.

7. Listed in descending order of total numbers, the business population is comprised of:
   A. sole proprietorships, corporations, and partnerships.
   B. sole proprietorships, partnerships, and corporations.
   C. partnerships, corporations, and sole proprietorships.
   D. corporations, partnerships, and sole proprietorships.

8. Listed in descending order of relative size, households divide their total incomes among:
   A. consumption expenditures, saving, and taxes.
   B. saving, consumption expenditures, and taxes.
   C. consumption expenditures, taxes, and saving.
   D. taxes, consumption expenditures, and saving.

9. Limited liability applies to:
   A. partnerships.
   B. proprietorships.
   C. all corporations.
   D. financial corporations but not to manufacturing corporations.
10. 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.

11. If there are important external benefits associated with the consumption of a product:
A. government should enact legislation to prohibit the production of the commodity.
B. special excise taxes should be levied on producers of the product.
C. the market demand curve understates the relative importance of the product and resources are therefore underallocated to its production.
D. the market supply curve for the product lies too far to the right to provide an efficient allocation of resources.

12. Refer to the above diagram, in which solid arrows reflect real flows; broken arrows are monetary flows. Flow (2) might represent:
A. the provision of national defense by government.
B. a government subsidy to farmers.
C. corporate income tax payments.
D. welfare payments to low-income families.

13. In economics, a physical establishment such as a factory, farm, mine, store, or warehouse that performs one or more functions in fabricating and distributing goods is called a(n):
A. industry.
B. plant.
C. conglomerate.
D. shop.

14. The Federal government requires automobile manufacturers to install pollution control equipment. This is an illustration of the:
A. intrusion problem.
B. production of public goods.
C. internalization of external benefits.
D. internalization of external costs.

15. 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.
16. Refer to the above diagram, in which solid arrows reflect real flows; broken arrows are monetary flows. If the economy were experiencing inflation due to excess aggregate spending, it would be most appropriate for government to:
A. increase flows (3) and (7) and reduce flows (2) and (6).
B. decrease flows (3) and (7) and increase flows (2) and (6).
C. increase flows (2) and (3) and reduce flows (6) and (7).
D. increase all of the monetary flows.

17. Government purchases and transfer payments:
A. differ because the latter absorb resources while the former do not.
B. differ because the former absorb resources while the latter do not.
C. are alike because both are more inflationary than private spending.
D. are alike because both absorb resources.

18. 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.

19. Suppose you own $50,000 of personal property, $5,000 of stock in General Statics Corporation, a $10,000 savings account, and $20,000 of government bonds. If General Statics goes bankrupt, the most you could lose is:
A. $50,000.
B. $5,000.
C. $35,000.
D. $85,000.

20. Transfer payments are about ____ percent of U. S. domestic output.
A. 50 percent
B. 5 percent
C. 12 percent
D. 22 percent

21. Total governmental purchases--Federal, state, and local combined--account for about what percentage of domestic output?
A. 30 percent
B. 19 percent
C. 10 percent
D. 5 percent
22. The average tax rate is:
A. equal to the marginal tax rate if the tax is progressive.
B. the total tax rate minus the marginal tax rate.
C. the ratio of total taxes paid to total taxable income.
D. the tax rate that applies to incremental dollars of income.

23. 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.

24. Assume that in year 1 your average tax rate is 20 percent on a taxable income of $20,000. If the marginal tax rate on the next $10,000 of taxable income is 30 percent, what will be the average tax rate if your taxable income rises to $30,000?
A. 7 percent
B. 30 percent
C. 16 percent
D. about 23 percent

25. 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.
26. Refer to the above diagram. The movement from point \( a \) to point \( c \) suggests that more:
A. private goods are being produced by employing currently idle resources.
B. public goods are being produced by employing currently idle resources.
C. public goods are being produced at the expense of fewer private goods.
D. private goods are being produced at the expense of fewer public goods.

27. When the production or consumption of a good involves an externality:
A. resources are necessarily overallocated to the product.
B. resources are necessarily underallocated to the product.
C. someone not involved in buying or selling the good is affected.
D. the market will efficiently allocate resources to its production.

28. As it relates to corporations, the principal-agent problem is that:
A. the goals of the corporate managers (the principals) may not match the goals of the corporate owners (the agents).
B. the goals of the corporate managers (the agents) may not match the goals of the corporate owners (the principals).
C. the Federal government (the agent) taxes both corporate profits and the dividends paid to stockholders (the principals).
D. it is costly for the corporate owners (the principals) to obtain a corporate charter from government (the agent).

29. Refer to the above diagram, in which solid arrows reflect real flows; broken arrows are monetary flows. Flow (4) might represent:
A. the services of NASA astrophysicists.
B. the purchase of Stealth bombers.
C. personal income taxes.
D. investment spending by private corporations.

30. Which of the following is a public good?
A. chewing gum
B. bread
C. a professional baseball game
D. street lights in a city

Pre-Test Chapter 4 ed17 Key

1. B
2. D
3. B
4. D
5. D
6. C
7. A
8. C
9. C
10. A
11. C
12. C
13. B
14. D
15. D
16. B
17. B
18. A
19. B
20. C
21. B
22. C
23. A
24. D
25. B
26. B
27. C
28. B
29. A
30. D