



CHAPTER 1

Individuals and Government

TRUE /FALSE QUESTIONS

1. On average, persons in the United States devote more of their annual budgets to taxes than they do to food. (T)
2. A universally observed function of government is the establishment of property rights. (T)
3. The total share of GDP accounted for by government spending in the United States has declined significantly since 1980. (F)
4. In 1929, the federal government spent more than was spent by state and local governments. (F)

5. Since 1930, the percent of GDP devoted to government expenditures has more than tripled. (T)
 6. The costs imposed by government regulations on business firms are included in budget data on government expenditures. (F)
 7. Government consumption does not require resources to be reallocated from private to government use. (F)
 8. Since 1959, the percent of federal government expenditures devoted to transfers has increased by more than 50 percent. (T)
 9. Transfer payments, including Social Security and welfare and medical assistance, account for nearly 60 percent of federal government expenditures. (T)
 10. Interest on the federal government's debt accounts for nearly one-quarter of federal government expenditure. (F)
 11. Federal grants-in-aid to state and local governments finance about 20 percent of annual spending by these governments. (T)
 12. The federal government allocates about 10 percent of its budget to Social Security. (F)
 13. State and local governments in the United States spend a bit more than one-third of their budgets on education. (T)
 14. Sales taxes account for about 22 percent of state and local government revenue in the United States. (T)
 15. The federal government obtains about half of its revenue annually from retail sales taxes. (F)
 16. State governments do not fund any part of Medicaid. (F)
 17. The *social compact* is an 18th century idea by political theorists. (F)
 18. The proportion of revenue received by the federal government from payroll taxes is higher than the proportion of revenue received by state and local governments from payroll taxes. (T)

MULTIPLE CHOICE QUESTIONS

1. The real cost of government goods and services is:
 - a. money.
 - b. taxes.
 - c. the private goods and services foregone.
 - d. inflation.
2. If the economy is currently operating on a point on the production possibility curve for government goods and services versus private goods and services,
 - a. an annual increase in government goods and services can be obtained without any sacrifice of annual private goods and services.
 - b. it will be impossible to increase annual output of government goods and services.
 - c. a decrease in the annual output of government goods and services will have no effect on the annual output of private goods and services.
 - d. a decrease in the annual output of government goods and services will allow an increase in annual output of private goods and services.

3. Government goods and services are usually:
 - a. not rationed by prices.
 - b. sold in markets.
 - c. made available to persons according to their willingness and ability to pay.
 - d. financed by revenue obtained from sales.
4. Taxes:
 - a. are prices paid for the right to consume government goods and services.
 - b. are compulsory payments not directly related to the benefits received from government goods and services.
 - c. never affect economic incentives.
 - d. are used by private firms to raise revenue.
5. A mixed economy is one in which:
 - a. there are no markets.
 - b. government activity accounts for a significant proportion of the value of goods and services produced.
 - c. there is no government.
 - d. all goods and services are sold in markets.
6. Government purchases for consumption and investment:
 - a. are made to acquire resources necessary to produce government goods and services.
 - b. are designed to redistribute purchasing power among citizens.
 - c. have increased in importance as a percent of federal spending since 1959.
 - d. do not withdraw resources from private use.
7. Transfer payments by the federal government in the United States account for about:
 - a. 25 percent of federal government expenditures.
 - b. 10 percent of federal government expenditures.
 - c. 40 percent of GDP.
 - d. 60 percent of federal government expenditures.
8. Total annual expenditures by federal, state, and local governments in the United States are in the range of:
 - a. 20 to 25 percent of annual GDP.
 - b. 25 to 30 percent of annual GDP.
 - c. 35 to 40 percent of annual GDP.
 - d. 45 to 50 percent of annual GDP.
9. Federal government expenditures in the United States account for about:
 - a. 25 percent of annual GDP.
 - b. 35 percent of annual GDP.
 - c. 45 percent of annual GDP.
 - d. 55 percent of annual GDP.

10. About 80 percent of federal receipts are accounted for by:
 - a. corporate profits taxes.
 - b. sales taxes.
 - c. excise taxes.
 - d. payroll and personal income taxes.
11. If the economy is operating at full employment and using resources efficiently, then an increase in spending for homeland security this year will:
 - a. require that resources be reallocated to homeland security services without sacrificing any alternative goods and services.
 - b. be possible if resources are reallocated to homeland security services, but it will also mean that the output of some other goods and services will have to fall.
 - c. be impossible.
 - d. be possible only if there is an improvement in technology or more resources made available.
12. Which of the following is an example of a political institution?
 - a. a market
 - b. elections with winners determined by majority rule
 - c. representative government
 - d. both (b) and (c)
13. Nonmarket rationing means that:
 - a. those willing to pay can buy as much of a product as they choose.
 - b. prices are used to sell products.
 - c. goods and services are not rationed by prices.
 - d. willingness to pay is not a factor in determining who can enjoy a good or service.
 - e. both (c) and (d)
14. The U.S. economy is best characterized as a:
 - a. pure market economy.
 - b. socialist economy.
 - c. pure capitalistic, free-enterprise system.
 - d. mixed economy.
15. State and local government expenditure in the United States accounts for about:
 - a. 32 percent of GDP.
 - b. 22 percent of GDP.
 - c. 12 percent of GDP.
 - d. 7 percent of GDP.
16. Following the circular flow of a mixed economy, firms receive a flow of dollars from and send goods and services to:
 - a. Output Markets.
 - b. Input Markets.
 - c. Households.
 - d. Government.

17. Following the circular flow of a mixed economy, which entity or entities distribute resources?
 - a. Firms only.
 - b. Input Markets only.
 - c. Government and Households.
 - d. Households and Input Markets.
18. When has the U.S. experienced government expenditures in the range of 40% to 50% of GDP?
 - a. 2000 to 2009.
 - b. 1950 to 1959.
 - c. 1940 to 1949.
 - d. It has never happened.
19. In 2011, which country listed below has the highest percentage of government spending relative to GDP?
 - a. France.
 - b. Ireland.
 - c. Japan.
 - d. Canada.
20. The old-age dependency ratio is:
 - a. the proportion of the population that is 60 years or older over the proportion of the population that is less than 60 years of age.
 - b. the proportion of the population that is 65 years or older over the proportion of the population that is 15 to 64 years of age.
 - c. the proportion of the population that is 70 years or older over the proportion of the population that is 20 to 69 years of age.
 - d. the total government expenditure on programs for the elderly over the number of citizens that are 65 years or older.

ESSAY QUESTIONS

1. Taxes are likely to affect the incentives that persons have to use their own resources in the most productive way. Suppose that the taxes used to finance G_1 units of government goods and services could purchase X_1 units of private goods and services. Assume that more than X_1 units of private goods and services could be produced if taxes did not impair incentives to produce. Use the production possibility curve to illustrate the effect of taxes on the output mix in the economy. Show the loss in private output from taxes on your graph. Show how an improvement in the technology of producing government goods and services will affect the production possibility curve.
2. What is the difference between transfer payments and government purchases? How has the mix of transfers and government purchases changed in the federal budget since 1960? List the most important transfer payments in the federal budget. What significant changes have occurred in the mix of all categories of federal government expenditures since 1960?

CHAPTER 2

Efficiency, Markets,

TRUE/FALSE QUESTIONS

1. The normative approach to public finance prescribes certain actions to achieve predetermined criteria. (T)
2. Positive economic analysis is based on underlying value judgments. (F)
3. “The government should abolish tariffs to achieve efficiency” is a normative statement. (T)
4. It is possible for efficiency *not* to be attained even if all production is carried on without waste. (T)
5. Efficiency is attained when resources are used each year in such a way that no further net gain is possible. (T)
6. The efficient annual output of any given good is attained if that good is made available in amounts up to the point at which the total social benefit of the good equals the total social cost. (F)
7. If the marginal social benefit of smoke detectors exceeds its marginal social cost, then additional net gains are possible from an increased annual smoke detector production. (T)
8. Monopoly power causes losses in efficiency because the marginal social benefit of output exceeds its marginal social cost at the monopoly output. (T)
9. Government regulations that require airlines to serve routes for which the maximum price that passengers are willing to pay for a trip fall short of the minimum price that sellers are willing to accept are likely to cause losses in efficiency. (T)
10. Points lying below a utility possibility curve are efficient. (F)
11. Government programs can achieve efficiency when the gains to gainers from those policies exceed the losses to those who bear the costs. (T)
12. If the marginal social cost of beer production exceeds its marginal social benefit, then more than the efficient amount of beer is being produced. (T)
13. Efficient outcomes are often viewed as inequitable. (T)
14. If it is not possible to make someone better off without harming another, then resource allocation is efficient. (T)

15. Compensation criteria are used to argue that changes in resource allocation should be made if the gains to some groups outweigh the losses to others, even though compensation for losses is not actually made. (T)
16. All points on a utility possibility curve are efficient but differ in terms of the distribution of well-being. (T)
17. A tax on a product shifts the demand curve. (F)
18. A government subsidized price for a commodity that is higher than the market driven price results in oversupply relative to the efficient allocation. (T)
19. When comparing the allocation of two goods relative to two consumers with individual utility functions, multiple points of Pareto efficiency can exist. (T)

MULTIPLE CHOICE QUESTIONS

1. Positive economics:
 - a. makes recommendations designed to achieve certain goals.
 - b. establishes cause-and-effect relationships between economic variables.
 - c. is based on value judgments.
 - d. can never be used to make predictions.
2. If the efficient output of a good is produced each week, then the:
 - a. marginal social benefit of the good equals its marginal social cost each week.
 - b. marginal social benefit of the good is at a maximum.
 - c. total social benefit of the good is at a maximum.
 - d. total social benefit of the good equals its total social cost.
3. If the marginal social benefit of a good exceeds the marginal social cost at the current monthly output, then:
 - a. it will be possible to make buyers of the good better off without harming sellers of the good.
 - b. it will be possible to make sellers of the good better off without harming buyers of the good.
 - c. either (a) or (b)
 - d. a reduction in monthly output will be required for efficiency.
4. The marginal social cost of bread exceeds the marginal social benefit at the current weekly output. Therefore,
 - a. the marginal net benefit of bread is positive.
 - b. the output of bread is efficient.
 - c. a reduction in weekly output of bread is necessary to achieve efficiency.
 - d. an increase in weekly output of bread is necessary to achieve efficiency.
5. The total social benefit of automobiles equals the total social cost at current annual output. Then it follows that:
 - a. the annual output of automobiles is efficient.
 - b. the annual output of automobiles exceeds the efficient amount.
 - c. less than the efficient annual output of automobiles is produced.

- d. it is not possible to make buyers of automobiles better off without harming sellers.
 - e. both (a) and (d)
6. Eggs are sold in a perfectly competitive market. No persons other than the buyers and sellers of eggs are affected in any way when eggs are traded in the market. Then it follows that:
- a. the price of eggs equals the marginal social cost of eggs.
 - b. the price of eggs equals the marginal social benefit of eggs.
 - c. the price of eggs exceeds the marginal social benefit of eggs.
 - d. both (a) and (b)
7. Diamonds are sold by a monopoly firm that maximizes profits. Then it follows that:
- a. the marginal social benefit of diamonds exceeds its marginal social cost.
 - b. the marginal social cost of diamonds exceeds its marginal social benefit.
 - c. the price of diamonds equals its marginal social cost.
 - d. the price of diamonds exceeds its marginal social benefit.
 - e. both (c) and (d)
8. Points on a utility possibility curve represent:
- a. a given distribution of well-being between two persons.
 - b. an efficient allocation of resources.
 - c. the maximum well-being of any one person, given the resources available and the well-being of another person.
 - d. all of the above
9. If efficiency has been attained,
- a. it will be possible to make any one person better off without harming another.
 - b. it will not be possible to make any one person better off without harming another.
 - c. perfect competition must exist.
 - d. the opportunity cost of any change in resource use must be zero.
10. A move from an inefficient resource allocation to an efficient one:
- a. will always be unanimously approved, even if gainers do not compensate losers.
 - b. will be unanimously opposed.
 - c. will be unanimously approved if gainers compensate losers.
 - d. can never result in losers.
11. Which of the following is a normative statement?
- a. When interest rates rise, the quantity of loanable funds demanded for new mortgages will decline.
 - b. To achieve efficiency, governments should prevent monopoly in markets.
 - c. Unemployment increases during a recession.
 - d. When governments increase income tax rates, people work less.
12. Normative economics:
- a. is not based on underlying value judgments.
 - b. makes recommendations to achieve efficient outcomes.
 - c. establishes cause-and-effect relationships between economic variables.
 - d. makes “if...then” type statements and checks them against the facts.

13. The extra benefit on one more unit of a good or service is its:
- a. marginal cost.
 - b. marginal benefit.
 - c. total benefit.
 - d. total cost.
14. If the efficient output of computers is achieved this year, then market price of computers is equal to:
- a. the marginal social benefit of computers.
 - b. the marginal social cost of computers.
 - c. the total social cost of computers.
 - d. the total social benefit of computers.
 - e. both (a) and (b)
15. Suppose the efficient output currently prevails in the market for ice cream. A tax on ice cream consumption will:
- a. allow efficiency to continue to prevail in the market.
 - b. result in more than the efficient output in the market.
 - c. result in less than the efficient output in the market.
 - d. cause the marginal social cost of ice cream to exceed its marginal social benefit at the market equilibrium output.
16. Positive economics is:
- a. an equity based approach in which income should be redistributed.
 - b. an objective approach without a particular goal based on underlying values.
 - c. a goal oriented approach based on desired policy outcomes.
 - d. a belief that governments can implement economic policies for the greater good of society.
17. Normative economics is:
- a. completely free of any value system.
 - b. completely objective.
 - c. based on a a conscious effort to implement a particular social goal.
 - d. an approach that determines the effect of particular actions without judgment of the result being good or bad.
18. An efficient level of output means:
- a. the total social benefit less the total social cost is maximized.
 - b. the total social benefit is below the total social cost.
 - c. the total social cost equals the total social benefit.
 - d. the total social benefit less the total social cost can be improved.
19. If a government desires to increase production beyond the current competitively determined efficient level, the government should:
- a. tax the good.
 - b. subsidize the good at a price higher than its current price.
 - c. set the price below its current price.
 - d. impose a fixed fee whenever the good is purchased.

20. Pareto efficiency between two consumers is achieved:
- a. only when the individual marginal rates of substitution are equal to the marginal rate of transformation.
 - b. only when the individual marginal rates of substitution are less than one, but not necessarily equal.
 - c. only when the individual marginal rates of substitution are greater than one and equal.
 - d. only when the individual marginal rates of substitution are equal.

ESSAY QUESTIONS

1. The wine industry is currently composed of many firms, and wine is sold in a perfectly competitive market. The wine industry produces the efficient annual output of wine, which is 100,000 bottles per year. The market equilibrium price is \$5 per bottle.
 - a. Draw the market demand and supply of wine and label the curves to show why the market output is the efficient output.
 - b. Suppose that the wine industry is consolidated into one large monopoly firm. As a result of the monopolization of the industry, the price of wine increase to \$7 per bottle, and the annual quantity demanded falls to 75,000 bottles. Explain why this output is not efficient and show the loss in net benefits resulting from monopolization of the industry.
2. Explain why points on a utility possibility curve represent efficient allocations of resources. Why must the utility possibility curve be downward sloping? Draw a utility possibility curve and show how it is possible to achieve efficiency by moving from a point within the curve and the axes to a point on the curve.

