

Chapter 3

Economic Decision Makers

These slides supplement the textbook, but should not replace reading the textbook

Who makes decisions in the economy ?

- Households
- Businesses
- Governments
- Foreigners

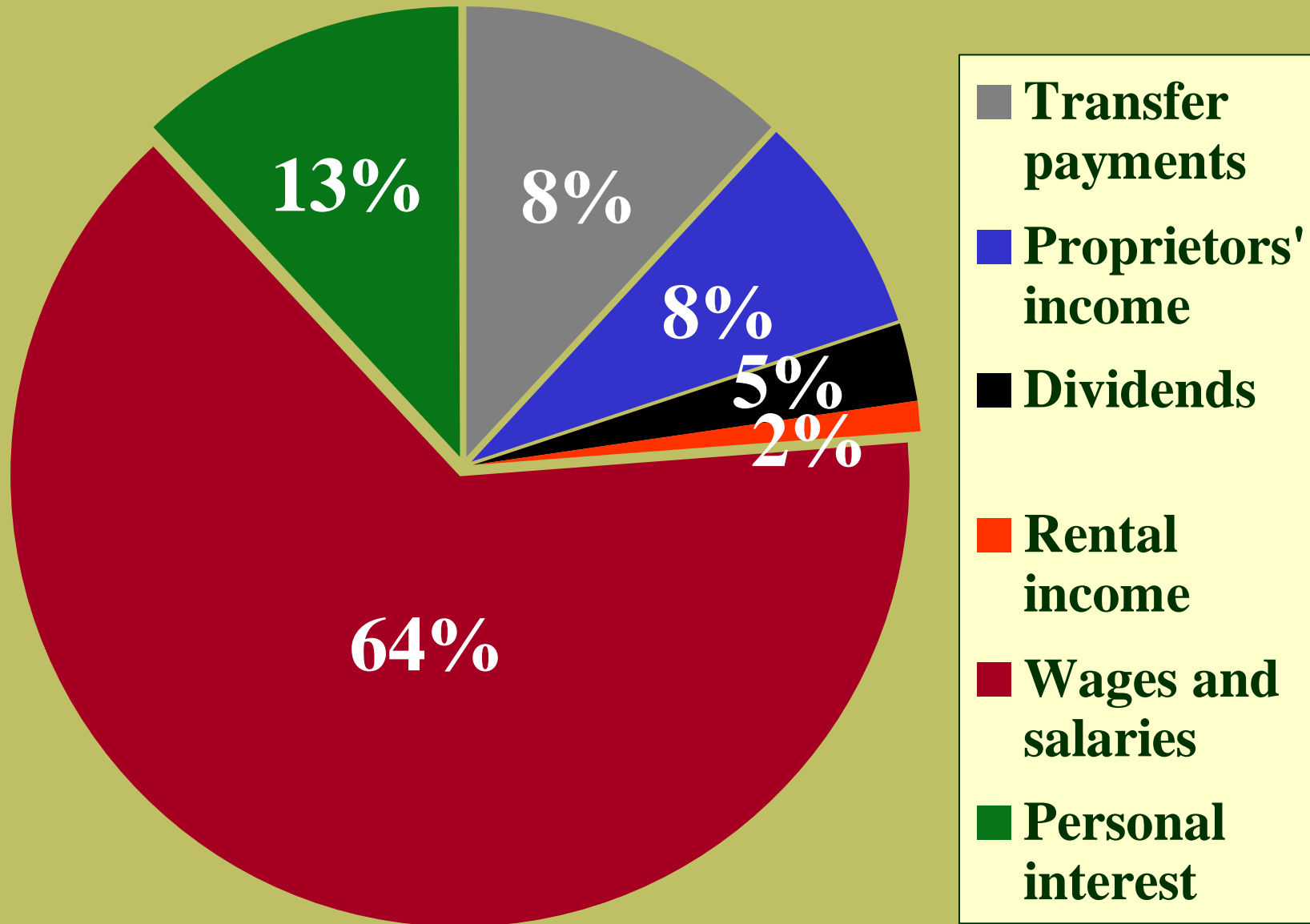
How has the typical household changed?

- More women are in the workforce
- The two income family is more common

Why are more women in the workforce?

- Inflation of the 1970's
- Higher education levels
- Higher wages
- Increase in the divorce rate
- Change in attitudes
- Higher taxes

Sources of U.S. Personal Income



What are transfer payments?

Cash or in-kind benefits given to individuals as outright grants from the government



On what do households spend their money?

- Durable goods
- Nondurable goods
- Services

Why does household production still exist?

- No skills or specialized resources are required
- Household production avoids taxes
- Household production reduces transaction costs
- Advances in technology

What are the three ways entrepreneurs organize firms?

- Sole proprietorships
- Partnerships
- Corporations

What is a sole proprietorship?

A firm with a single owner who has the right to all profits and who bears unlimited liability for the firm's debts

What is a partnership?

A firm with multiple owners who share the firm's profits and each of whom bears unlimited liability for the firm's debts

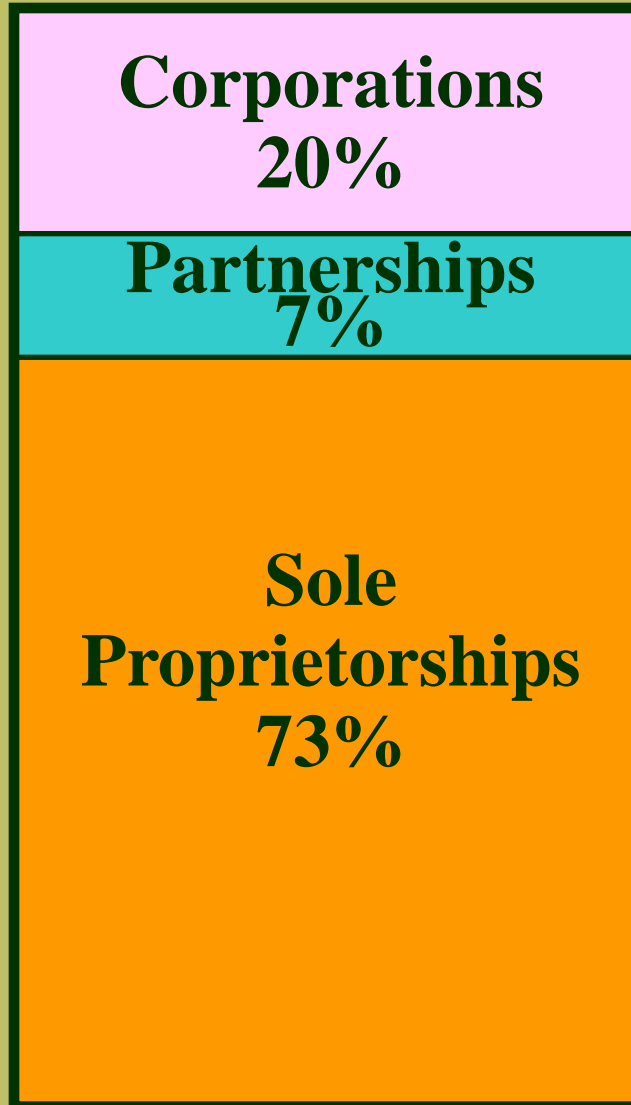
What is a corporation?

A legal entity owned by stockholders whose liability is limited to the value of their stock

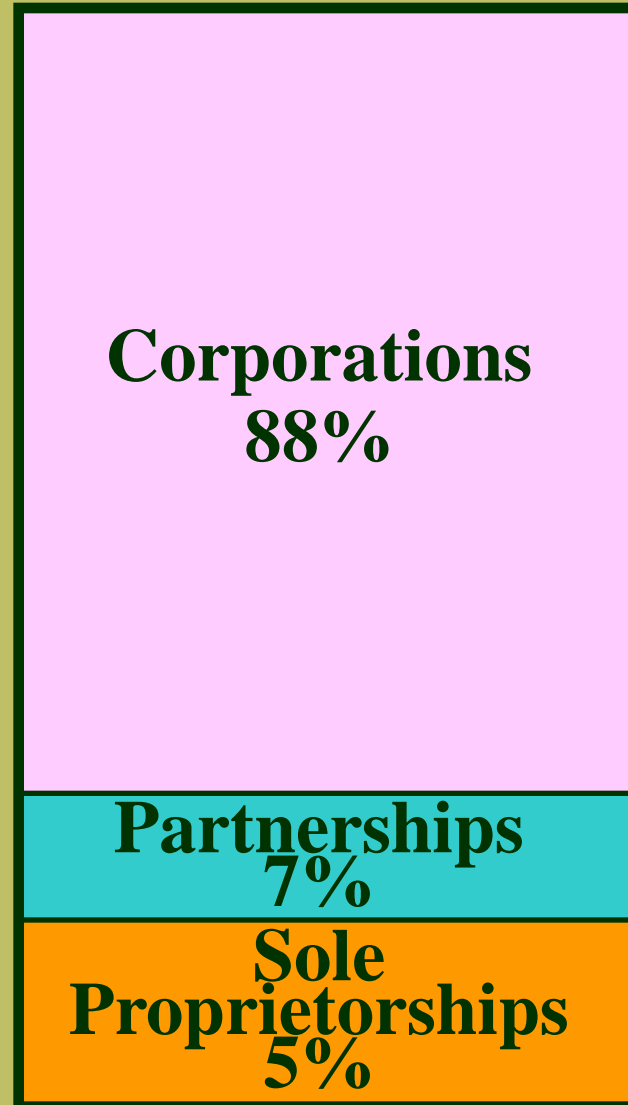
What are the three types of corporations?

- C
- Chapter S
- Limited Liability

Percentage of firms by type



Percentage of sales by type

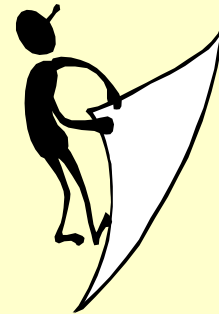


What is market failure?

A condition that arises when unrestrained operation of markets yields socially undesirable results

What is the role of government?

The government ...



- Establishes & enforces rules of the game
- Promotes competition
- Regulates natural monopolies
- Provides public goods
- Deals with externalities
- Promotes a more equal distribution of income
- Strives for full employment, price stability, and economic growth

How does the government establish and enforce rules of the game?

It safeguards private property and enforces contracts



How does the government promote competition?

Antitrust laws try to promote competition by prohibiting collusion and other anticompetitive practices

What is a monopoly?

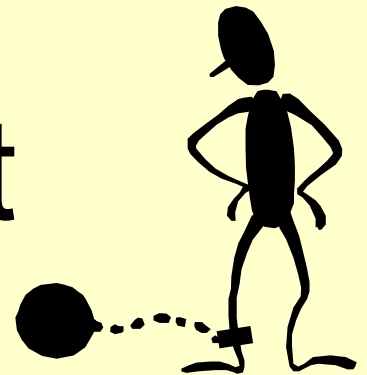
The sole producer of a product for which there are no good substitutes

What is a natural monopoly?

One firm that can serve the entire market at a lower per-unit cost than can two or more firms

What is the downside for a natural monopoly?

It is regulated by the government



What is a public good?

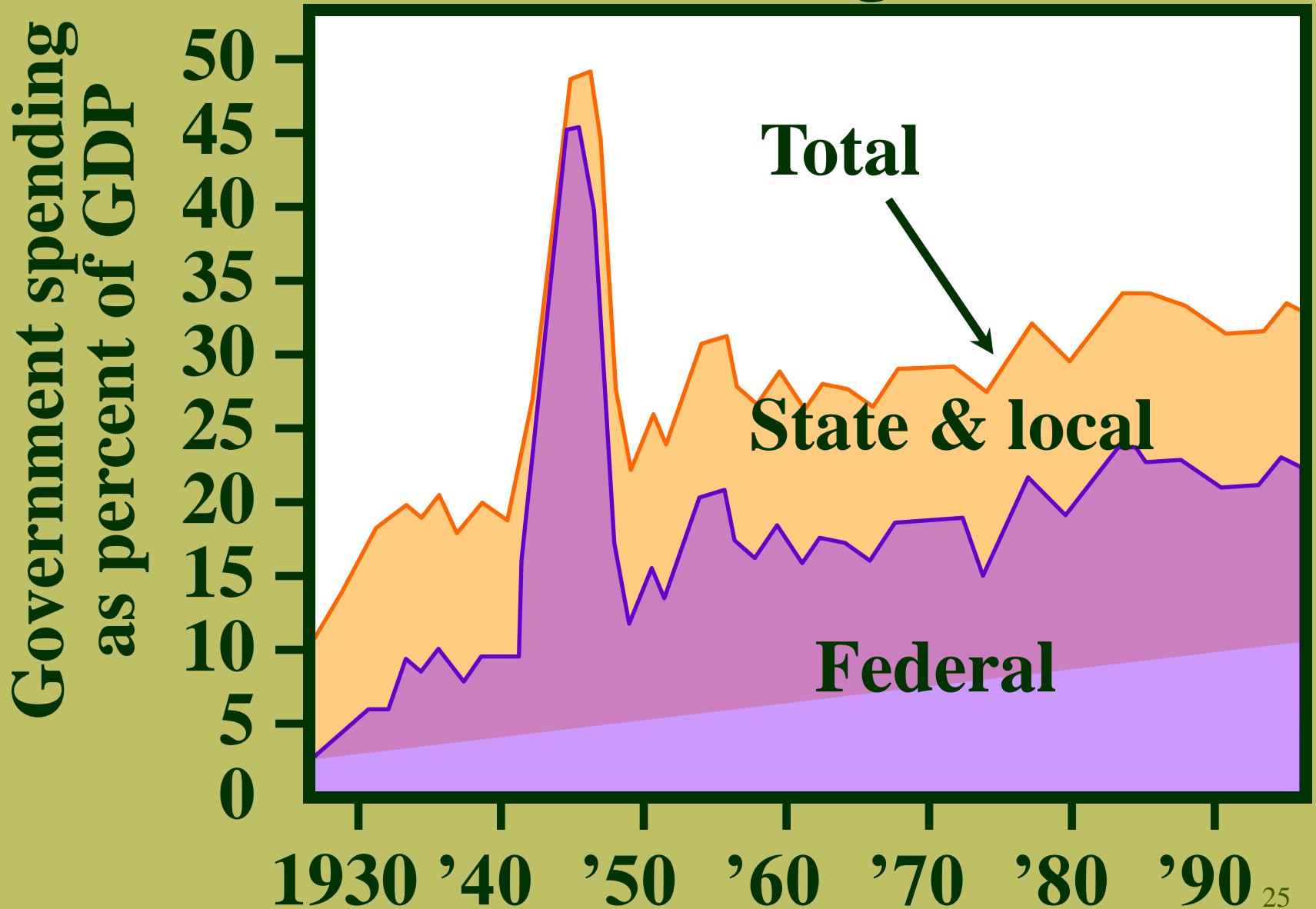
A good that is available
for all to consume,
regardless of who pays
and who does not

How does the government provide for public goods?

Taxes



Government Spending in U.S. Since 1929 as Percentage of GDP



What is an externality?

A cost or a benefit that falls on third parties and is therefore ignored by the two parties to the market transaction

How does the government deal with externalities?

It employs taxes, subsidies, and regulations to discourage negative externalities and to encourage positive externalities

**How does the
government promote a
more *equal* distribution
of income?**

Transfer payments

**How does the
government promote
full employment, price
stability, & growth?**

By using monetary
and fiscal policies

What is a fiscal policy?

The use of government to influence aggregate economic activity through taxing and spending

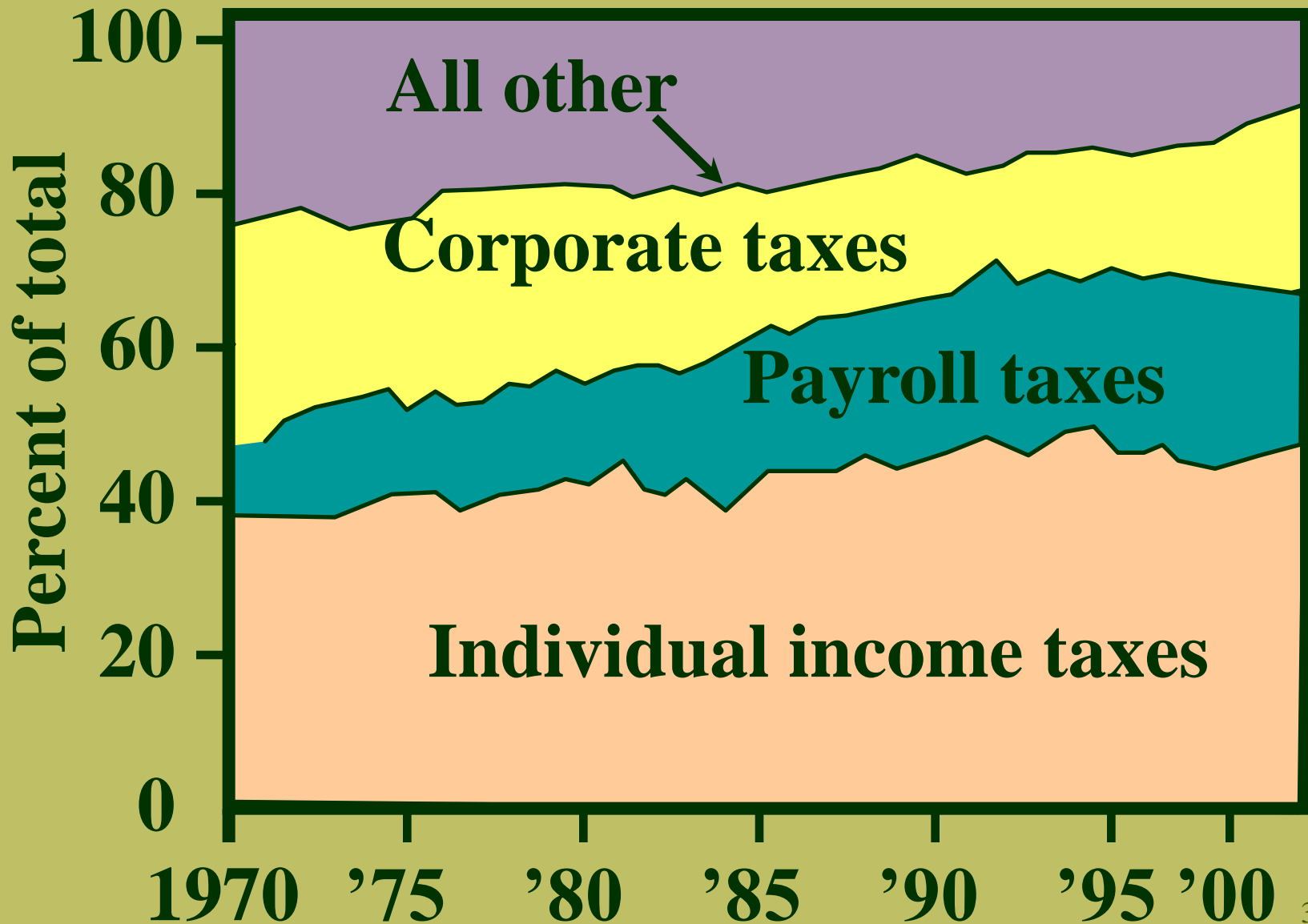
What is a monetary policy?

Regulation of the
money supply in order
to influence aggregate
economic activity

What is a federal system of government?

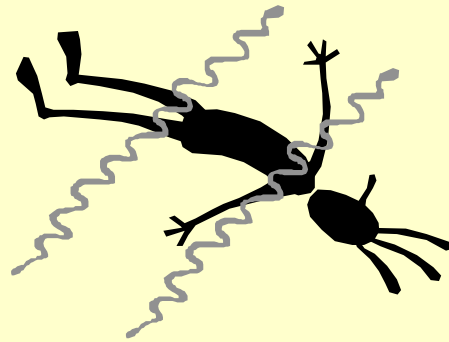
Responsibilities are shared across levels of government

Percentage Composition of Federal Receipts Since 1970 (share of total)



What is tax incidence?

The distribution of tax burden among tax payers



What is the ability to pay principle of taxation?

Those with a greater ability to pay should pay more tax

What is the benefits received principle of taxation?

Those who receive more benefits from government programs funded by a tax should pay more tax

What is proportional taxation?

The tax as a percentage of income remains constant as income increases; also called a flat rate tax

What is progressive taxation?

The tax as a percentage of income increases as income increases

What is marginal tax rate?

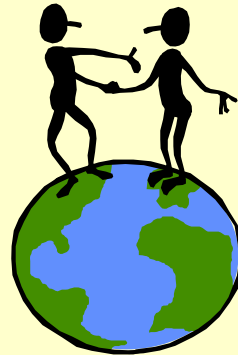
The percentage of each additional dollar of income that goes to taxes

What is a regressive tax?

The tax as a percentage
of income decreases
as income increases

Why does *international* trade occur?

The opportunity cost of producing specific goods differs among countries

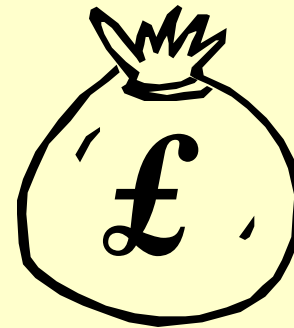


What is merchandise trade balance?

The value of a country's exported goods minus the value of its imported goods during a given time period

What is foreign exchange?

The currency of another country needed to carry out international transactions



What is balance of payments?

A record of all economic transactions between residents of one country and residents of the rest of the world during a given time period

What forms do restrictions on trade take?

- Tariffs
- Quotas
- Other restrictions, such as agreements among manufacturers



What is a tariff?

A tax on imports or exports



What is a quota?

A legal limit on the quantity of a particular product that can be imported or exported

Why do countries restrict trade?



- To benefit domestic producers who lobby for protective legislation
- national defense
- protect infant industries
- foster diversification
- protect jobs

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