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Chapter 2
Markets and Contracts

Multiple Choice Questions

1. What do we call markets where assets trade at prices that reflect all available information?
    a. Auction markets
    b. Direct markets
    c. Secondary markets
    d. Efficient markets
    e. Real asset markets
    Answer: D

2. Which of the following is NOT TRUE of the progressive tax system in the U.S. for couples filing a joint return?
    a. Total tax paid divided by total income earned is equal to the highest marginal tax rate
    b. The lowest rate of taxation is attached to the lowest level of income
    c. The highest rate of taxation is attached to the highest level of income
    d. Couples with higher income will pay more total tax compared with lower income couples
    e. Not every couple will have enough income to make it into the highest bracket of income
    Answer: A

3. How does the economic system, as presented in Chapter 2 and in the course notes, view financial intermediaries?
    a. As direct owners of real assets, both tangible and intangible
    b. As vehicles that transfer ownership of real assets by people to indirect ownership by society
    c. As conduits or buffers between real assets and people
    d. As contracts between principles and agents
    e. As providers of publicly available information such as financial statements
    Answer: C

4. Which of the following is TRUE of the progressive tax system in the U.S. for couples filing a joint return?
    a. The highest rate of taxation is attached to the lowest level of income
    b. For almost all couples, the average tax rate is less than the marginal tax rate
    c. Couples with higher income almost always pay less tax compared to lower income couples
    d. Total tax paid divided by total income earned is equal to the highest marginal tax rate
    e. The marginal tax rate is the rate of tax paid on the average dollar of income
    Answer: B

5. Felix and Freddie are married with annual taxable income of $230,000. They pay income tax according to the following schedule:

Over	But Not Over	Tax Rate
$0	$43,850	15%
$43,850	$105,950	???
$105,950	$361,450	31%

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If the total personal income tax they pay is $59,316, which of the following comes closest to the tax rate for income between $43,850 and 105,950 (the middle tax rate)?

a. 21%
b. 22%
c. 23%
d. 24%
e. 25%

Answer: C

6. Consistent with the text's conception of the economic system, how are taxes described?
   a. The cost of doing business for the government
   b. Claims by recipients of government services against taxpayers on the basis of contracts that comprise the government
   c. As a necessary evil, but no longer matter
   d. As investments through a financial intermediary
   e. As a good example of markets that are efficient, that is, markets in which prices reflect all available information.

   Answer: B

7. From the following list, identify the financial asset.
   a. The company's administrative building, which houses the finance department
   b. Land purchased by the company from a local finance company
   c. The company's corporate checking accounts
   d. The company's inventories of raw materials
   e. All of the above are examples of financial assets

   Answer: C

8. Assume the following tax code for a married couple: 15% up to $20,350; 28% between $20,350 and $49,300; 31% above $49,300. Which of the following comes closest to the tax payable on $60,189?
   a. $9,028
   b. $14,847
   c. $18,659
   d. $14,534
   e. $15,023

   Answer: D

9. What is a characteristic of an inefficient market?
   a. A market where prices can go down but not up
   b. A market where trading is limited to a few hours each week-day and no weekend trading
   c. A market where assets trade at prices that do not reflect all available information
   d. A market where the costs of transactions is high
   e. A market where brokers do not work as effectively as they possibly can

   Answer: C

10. Justin believes that he can beat the market by studying charts of publicly available past prices and trading volume and searching for patterns in past price movements in order to decide which securities to buy and sell. From this information what can we say about Justin?
    a. He supports the semi-strong form of market efficiency
    b. He supports the weak form of market efficiency
    c. He rejects the semi-strong form of market efficiency

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d. He rejects the weak form of market efficiency
e. He supports the strong form of market efficiency

Answer: D

11. Which of the following is a tool used to minimizing agency costs?
    a. Inflation
    b. Taxation
    c. Compensation plans
    d. Intermediation
    e. Liquidity

    Answer: C

12. In a particular market, individuals buy and sell securities using their own inventory and earn a commission equal to the difference between the price the buyer pays and the price the seller receives. What do we call this type of market?
    a. A secondary market.
    b. A dealer market.
    c. A primary market.
    d. A weak form efficient market.
    e. A strong form efficient market

    Answer: B

13. How is an efficient market characterized?
    a. Assets trading at prices above their value
    b. Assets trading at prices below their value
    c. Assets trading at prices equal to their value
    d. Assets trading at prices either above or below their value, depending upon modern portfolio theory
    e. Assets that are technically in the form of semi-weak

    Answer: C

14. Assume the following tax code for a married couple: 15% up to $24,300; 28% between $24,300 and $47,500; and 31% above $47,500. What is the tax payable on an income of $118,000 (rounded to the nearest dollar)?
    a. $27,475
    b. $31,996
    c. $24,300
    d. $8,750
    e. $47,500

    Answer: B

15. The Epstein's are married with annual taxable income of $150,000. They pay income tax according to the following schedule:

Over	But Not Over	Tax Rate
$0	$50,000	15%
$50,000	$100,000	25%
$100,000	$500,000	???

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If the total personal income tax they pay is $40,000, which of the following comes closest to the tax rate for income between $100,000 and 500,000?

a. 30%
b. 33%
c. 35%
d. 38%
e. 40%

Answer: E

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