

Chapter 25

Saving, Investment, and the Financial System

Test A

1. When a country saves a smaller portion of its GDP, it will have
 - a. more investment, and so have more capital and higher productivity.
 - b. more investment, and so have less capital and lower productivity.
 - c. less investment, and so have more capital and higher productivity.
 - d. less investment, and so have less capital and lower productivity.

ANSWER: d. less investment, and so have less capital and lower productivity.

TYPE: M KEY1: D OBJECTIVE: 1 RANDOM: Y

2. What are the two basic categories of financial institutions?
 - a. the foreign exchange markets and the stock markets
 - b. the financial markets and financial intermediaries
 - c. the market for loanable funds and the market for capital
 - d. the lending market and the deposit market

ANSWER: b. the financial markets and financial intermediaries

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

3. Which of the following is not a nonsensical headline?
 - a. British perpetuities about to mature.
 - b. Disney issues new bonds with term of \$1,000 each.
 - c. Government bonds currently pay less interest than corporate bonds.
 - d. Standard and Poor's judges new junk bond to have very low credit risk.

ANSWER: c. Government bonds currently pay less interest than corporate bonds.

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

4. A certificate of indebtedness that specifies the obligations of the borrower to the holder is called a
- stock.
 - mutual fund.
 - bond.
 - All of the above are correct.

ANSWER: c. bond.

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

5. Rudolph has the choice of two bonds, one that pays 5 percent interest and the other that pays 10 percent interest. Which of the following is most likely?
- The 10 percent bond is less risky than the 5 percent bond
 - The 10 percent bond has a shorter term than the 5 percent bond
 - The 10 percent bond is a U.S. government bond, and the 5 percent bond is a junk bond
 - The 10 percent bond is a corporate bond, and the 5 percent bond is a municipal bond

ANSWER: d. The 10 percent bond is a corporate bond, and the 5 percent bond is a municipal bond.

TYPE: M KEY1: C SECTION: 1 OBJECTIVE: 1 RANDOM: Y

6. People who buy stock in a corporation such as Maytag become
- creditors of Maytag, so the benefits of holding the stock depend on Maytag's profits.
 - creditors of Maytag, but the benefits of holding the stock do not depend on Maytag's profits.
 - part owners of Maytag, so the benefits of holding the stock depend on Maytag's profits.
 - part owners of Maytag, but the benefits of holding the stock do not depend on Maytag's profits.

ANSWER: c. part owners of Maytag, so the benefits of holding the stock depend on Maytag's profits.

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

7. Stock indexes are
- reports in the newspapers that report on the price of the stock and earnings of individual corporations over time.
 - the average of a group of stock prices.
 - measures of the risk relative to the profitability of corporations.
 - measures of the price of a stock relative to its risk.

ANSWER: b. the average of a group of stock prices.

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

8. A corporation has a price of \$25, a dividend of \$.50, and retained earnings of \$.30 per share. The dividend yield on this stock is
- 3.2 percent.
 - 2 percent.
 - 1.7 percent.
 - 1 percent.

ANSWER: b. 2 percent.

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

9. A mutual fund
- is a financial market where small firms sell stocks and bonds to raise funds.
 - is money set aside by local governments to lend to small firms who want to invest in projects that are mutually beneficial to the firm and community.
 - sells stocks and bonds on behalf of small and not-very-well-known firms who would otherwise have to pay high interest to obtain credit.
 - sells shares to the public and uses the proceeds to buy a selection of various types of stocks, bonds, or both stocks and bonds.

ANSWER: d. sells shares to the public and uses the proceeds to buy a selection of various types of stocks, bonds, or both stocks and bonds.

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

10. Which of the following equations represents national saving in a closed economy?
- $Y - I - G - NX$
 - $Y - C - G$
 - $Y - I - C$
 - $G + C - Y$

ANSWER: b. $Y - C - G$

TYPE: M KEY1: E SECTION: 2 OBJECTIVE: 2 RANDOM: Y

11. In a closed economy, national saving equals
- income minus private consumption.
 - private saving minus public saving.
 - investment.
 - All of the above are correct.

ANSWER: c. investment.

TYPE: M DIFFICULTLY: 3 KEY1: C SECTION: 2 OBJECTIVE: 2 RANDOM: Y

12. Suppose that in a closed economy GDP is equal to 9,000, taxes are equal to 1,000, Consumption equals 6,000, and government expenditures equal 2,000. What are private saving and public saving?
- a. 2000 and – 1000
 - b. 2000 and 1000
 - c. 1000 and – 1000
 - d. 1000 and 2000

ANSWER: a. 2000 and – 1000

TYPE: M KEY1: E SECTION: 2 OBJECTIVE: 2 RANDOM: Y

13. A budget surplus is created when the government
- a. sells more bonds than it buys back.
 - b. spends more than it receives in tax revenue.
 - c. receives more tax revenue than it spends.
 - d. None of the above is correct.

ANSWER: c. receives more tax revenue than it spends.

TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 2 RANDOM: Y

14. The source of the demand for loanable funds
- a. and the supply of loanable funds is saving.
 - b. and the supply of loanable funds is investment.
 - c. is saving and the source of the supply of loanable funds is investment.
 - d. is investment and the source of the supply of loanable funds is saving.

ANSWER: d. is investment and the source of the supply of loanable funds is saving.

TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 3 RANDOM: Y

15. The supply of loanable funds slopes
- a. downward because an increase in the interest rate induces people to save less.
 - b. downward because an increase in the interest rate induces people to invest less.
 - c. upward because an increase in the interest rate induces people to save more.
 - d. upward because an increase in the interest rate induces people to invest more.

ANSWER: c. upward because an increase in the interest rate induces people to save more.

TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 3 RANDOM: Y

16. A lower interest rate induces people to
- save less, so the demand for loanable funds slopes upward.
 - save less, so the demand for loanable funds slopes downward.
 - invest more, so the demand for loanable funds slopes upward.
 - invest more, so the demand for loanable funds slopes downward.

ANSWER: d. invest more, so the demand for loanable funds slopes downward.

TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 3 RANDOM: Y

17. If the current market interest rate for loanable funds is below the equilibrium level, then the quantity of loanable funds
- demanded exceeds the quantity of loanable funds supplied and the interest rate will fall.
 - demanded exceeds the quantity of loanable funds supplied and the interest rate will rise.
 - supplied exceeds the quantity of loanable funds demanded and the interest rate will fall.
 - supplied exceeds the quantity of loanable funds demanded and the interest rate will rise.

ANSWER: b. demanded exceeds the quantity of loanable funds supplied and the interest rate will rise.

TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 3 RANDOM: Y

18. If the inflation rate is 3 percent and the real interest rate is 9 percent, then the nominal interest rate is
- 12 percent.
 - 6 percent.
 - 3 percent.
 - 1/3 percent.

ANSWER: a. 12 percent.

TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 3 RANDOM: Y

19. Promises of future payments have the largest present value when interest rates are
- high and the time until the future payment is received is long.
 - high and the time until the future payment is received is short.
 - low and the time until the future payment is received is long.
 - low and the time until the future payment is received is short.

ANSWER: d. low and the time until the future payment is received is short.

TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 3 RANDOM: Y

20. What would happen in the market for loanable funds if the government were to decrease the tax on interest income?
- a. The supply of loanable funds would shift right.
 - b. The supply of loanable funds would shift left.
 - c. The demand for loanable funds would shift right.
 - d. The demand for loanable funds would shift left.

ANSWER: a. The supply of loanable funds would shift right.

TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 4 RANDOM: Y

21. If Congress raised the tax on interest income, investment
- a. and saving would increase.
 - b. and saving would decrease.
 - c. would increase and saving would decrease.
 - d. would decrease and saving would increase.

ANSWER: b. and saving would decrease.

TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 3 RANDOM: Y

22. Which of the following is incorrect?
- a. Taxes on interest income do not substantially decrease future payments from current saving.
 - b. American families save a smaller fraction of their incomes than their counterparts in many other countries such as Germany and Japan.
 - c. Saving is an important long-run determinant of a nation's standard of living.
 - d. A change in the tax law that encouraged greater saving would reduce interest rates.

ANSWER: a. Taxes on interest income do not substantially decrease future payments from current saving.

TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 4 RANDOM: Y

23. Suppose that Congress were to institute an investment tax credit. What would happen in the market for loanable funds?
- a. The supply of loanable funds would shift left.
 - b. The supply of loanable funds would shift right.
 - c. The demand for loanable funds would shift left.
 - d. The demand for loanable funds would shift right.

ANSWER: d. The demand for loanable funds would shift right.

TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 4 RANDOM: Y

24. An increase in the budget deficit shifts the
- a. demand for loanable funds left.
 - b. demand for loanable funds right.
 - c. supply of loanable funds left.
 - d. supply of loanable funds right.

ANSWER: c. supply of loanable funds left.

TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 5 RANDOM: Y

25. Which of the following beliefs would make someone less likely to oppose government deficits?
- a. The return on private investment is higher than the return on public investment.
 - b. Taxes considerably distort private decision making.
 - c. The demand for loanable funds curve is very steep.
 - d. All of the above would make someone less likely to oppose government deficits.

ANSWER: c. The demand for loanable funds curve is very steep.

TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 5 RANDOM: Y

1 ANSWER: d. less investment, and so have less capital and lower productivity.

TYPE: M KEY1: D OBJECTIVE: 1 RANDOM: Y

2 ANSWER: b. the financial markets and financial intermediaries

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

3 ANSWER: c. Government bonds currently pay less interest than corporate bonds.

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

4 ANSWER: c. bond.

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

5 ANSWER: d. The 10 percent bond is a corporate bond, and the 5 percent bond is a municipal bond.

TYPE: M KEY1: C SECTION: 1 OBJECTIVE: 1 RANDOM: Y

6 ANSWER: c. part owners of Maytag, so the benefits of holding the stock depend on Maytag's profits.

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

7 ANSWER: b. the average of a group of stock prices.

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

8 ANSWER: b. 2 percent.

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

9 ANSWER: d. sells shares to the public and uses the proceeds to buy a selection of various types of stocks, bonds, or both stocks and bonds.

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

10 ANSWER: b. Y - C - G

TYPE: M KEY1: E SECTION: 2 OBJECTIVE: 2 RANDOM: Y

11 ANSWER: c. investment.

TYPE: M DIFFICUTLY: 3 KEY1: C SECTION: 2 OBJECTIVE: 2 RANDOM: Y

12 ANSWER: a. 2000 and -1000

TYPE: M KEY1: E SECTION: 2 OBJECTIVE: 2 RANDOM: Y

13 ANSWER: c. receives more tax revenue than it spends.

TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 2 RANDOM: Y

14 ANSWER: d. is investment and the source of the supply of loanable funds is saving.

TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 3 RANDOM: Y

15 ANSWER: c. upward because an increase in the interest rate induces people to save more.

TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 3 RANDOM: Y

16 ANSWER: d. invest more, so the demand for loanable funds slopes downward.

TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 3 RANDOM: Y

17 ANSWER: b. demanded exceeds the quantity of loanable funds supplied and the interest rate will rise.

TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 3 RANDOM: Y

18 ANSWER: a. 12 percent.

TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 3 RANDOM: Y

19 ANSWER: d. low and the time until the future payment is received is short.

TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 3 RANDOM: Y

20 ANSWER: a. The supply of loanable funds would shift right.

TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 4 RANDOM: Y

21 ANSWER: b. and saving would decrease.

TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 3 RANDOM: Y

22 ANSWER: a. Taxes on interest income do not substantially decrease future payments from current saving.

TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 4 RANDOM: Y

23 ANSWER: d. The demand for loanable funds would shift right.

TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 4 RANDOM: Y

24 ANSWER: c. supply of loanable funds left.

TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 5 RANDOM: Y

25 ANSWER: c. The demand for loanable funds curve is very steep.

TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 5 RANDOM: Y