

NAME: _____ Student ID: _____



College of Business Administration
Department of Economics
Principles of Macroeconomics
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ECO 2013 - 0008
Spring 2004

QUIZ IV – Version 1

- This closed book QUIZ is worth 100 points.
The exam totals 45 Multiple-Choice questions and 1 Short-Essay question.
Each Multiple-Choice question is worth 2 points.
The Short-Essay question is worth 10 points.
Allocate your time accordingly.
- Including the cover page, the exam totals 12 pages.
- DO NOT forget to write your name and your student id on the exam booklet.
- Non-Programmable calculators and language dictionaries are allowed.
- At the end of the exam, hand-in the exam booklet and the computer sheet to the examiner.

March 24, 2004

4:35 p.m. – 5:40 p.m.

BA 2-210

Multiple-Choice Questions (90 points)

1. Private saving is positive when:
 - a) the government's budget is balanced.
 - b) after-tax income of households and businesses is less than consumption expenditure.
 - c) after-tax income of households and businesses is greater than consumption expenditures.
 - d) there is a government budget deficit.
 - e) there is a government budget surplus.

2. Holding other factors constant, if new environmental regulations increase firms' cost of operating capital, then the real interest rate will ____ and the equilibrium quantity of national saving and investment will ____.
 - a) decrease; increase
 - b) decrease; decrease
 - c) increase; decrease
 - d) increase; not change
 - e) increase; increase

3. If net taxes paid by households increase,:
 - a) private saving will increase.
 - b) transfer payments to households will increase.
 - c) transfer payments to households will decrease.
 - d) private saving will decrease.
 - e) public saving will decrease.

4. When the Federal Reserve sells government bonds to the public, this is an example of a(n):
 - a) discount loan.
 - b) bank panic.
 - c) change in reserve requirements.
 - d) open-market purchase.
 - e) open-market sale.

5. The U.S. Congress instituted a system of deposit insurance for banks in:
a) 1865 b) 1913 c) 1934 d) 1776 e) 1789

6. Which of the following is a flow?
 - a) money
 - b) saving
 - c) liabilities
 - d) wealth
 - e) assets

7. Barter is:
- a) a means of channeling funds from savers to borrowers with productive investment opportunities.
 - b) the direct trade of goods and services for other goods and services.
 - c) an equity claim to ownership.
 - d) an asset used in purchasing goods and services.
 - e) the extension of credit to borrowers using funds raised from savers.
8. The Federal Open Market Committee makes decisions about ____ policy.
- a) fiscal b) banking c) structural d) monetary e) deposit insurance
9. In an open-market sale the Federal Reserve ____ government bonds and the supply of bank reserves ____.
- a) buys; decreases
 - b) sells; decreases
 - c) buys; increases
 - d) sells; increases
 - e) sells; does not change
10. Holding other factors constant, a decline in the price of new capital goods will:
- a) decrease national saving
 - b) increase the value of the marginal product of capital.
 - c) decrease investment
 - d) increase national saving
 - e) increase investment
11. Charles has the following assets and liabilities:
- | | |
|--------------------------|-----------|
| Two cars | \$ 10,000 |
| House | \$200,000 |
| Mortgage | \$100,000 |
| Cash | \$ 1,000 |
| Car loans | \$ 3,000 |
| Checking account balance | \$ 2,000 |
| | \$ |
- What is Charles's wealth?
- a) \$317,000 b) \$107,000 c) \$213,000 d) \$109,000 e) \$111,000
12. The introduction of credit cards and debit cards has ____ velocity.
- a) doubled b) eliminated c) increased d) had no impact on e) decreased

- 18.** When the central bank sells \$1,000,000 worth of government bonds to the public, the money supply:
- a) decreases by \$1,000,000.
 - b) decreases by less than \$1,000,000.
 - c) increases by \$1,000,000.
 - d) decreases by more than \$1,000,000.
 - e) does not change.
- 19.** Social Security benefits, welfare payments, and farm support payments are examples of:
- a) government spending
 - b) investment spending
 - c) transfer payments
 - d) public interest payments
 - e) consumption spending
- 20.** Money is:
- a) the sum of assets minus debts.
 - b) the market value of all final goods and services produced in a country in a year.
 - c) all financial assets.
 - d) any asset used to make purchases.
 - e) the same as income.
- 21.** Saving divided by income equals the ____ rate.
- a) investment
 - b) wealth
 - c) interest
 - d) asset
 - e) saving
- 22.** If the saving rate in an economy decreases and capital gains (net of capital losses) are earned of an amount equal, the economy's:
- a) wealth will increase.
 - b) wealth will remain unchanged.
 - c) liabilities will decrease.
 - d) wealth will decrease.
 - e) assets will decrease.
- 23.** You are given the following information about the economy:

Household saving	300
Business saving	700
Government purchases	1,000
Government transfers and interest payments	500
Government tax collections	1,500

Private saving is _____ and national saving is _____.

- a) 1,000; 2,000
- b) 1,000; 1,500
- c) 700; 0
- d) 300; -200
- e) 1,000; 1,000

24. The direct trade of goods and services for other goods and services is called:
- a) the efficient allocation of resources.
 - b) barter.
 - c) using a medium of exchange.
 - d) financial intermediation.
 - e) diversification.
25. After the Federal Reserve increases reserves in the banking system through open-market purchases, banks create new deposits through multiple rounds of lending and accepting deposits until the:
- a) deposit insurance limit is reached.
 - b) actual reserve/deposit ratio is greater than the desired reserve/deposit ratio.
 - c) actual reserve/deposit ratio is less than the desired reserve/deposit ratio.
 - d) Federal Reserve requires them to stop.
 - e) actual reserve/deposit ratio is equal to the desired reserve/deposit ratio.
26. To the extent that households are target savers, who save to reach a specific goal, a decrease in the interest rate _____ household saving.
- a) may either increase or decrease
 - b) does not affect
 - c) increases
 - d) decreases
 - e) cuts in half
27. You are given the following information about the economy:
- | | |
|--------------------------------------------|-------|
| Consumption | 3000 |
| Government budget surplus | 500 |
| Government transfers and interest payments | 750 |
| Government tax collections | 1,750 |
| GDP | 6,000 |
- Public saving is _____ and national saving is _____.
- a) 500; 3,500
 - b) 500; 500
 - c) 1,250; 2,000
 - d) 500; 2,500
 - e) 750; 2,750
28. An increase in net taxes (i.e., taxes paid by the private sector to the government less transfer payments and interest payments made by the government to the private sector) will:
- a) cause crowding out.
 - b) increase private saving.
 - c) reduce investment in new capital equipment.
 - d) decrease public saving.
 - e) increase public saving.

- 34.** The opportunity cost of capital investment is the:
- a) price of the firm's output.
 - b) real interest rate.
 - c) price of new capital goods.
 - d) value of the marginal product of labor.
 - e) value of the marginal product of capital.
- 35.** The voting members of the Federal Open Market Committee consist of _____ governors of Board of Governors and _____ of the regional Federal Reserve Bank presidents.
- a) 7; 12 b) 7; 5 c) 7; 14 d) 5; 12 e) 5; 7
- 36.** The most important tool of monetary policy is:
- a) open market operations.
 - b) reserve requirement ratios.
 - c) market interest rates.
 - d) the discount rate.
 - e) the minimum net worth required of banks.
- 37.** If the reserve/deposit ratio is less than 100%, then the banking system engages in:
- a) the double coincidence of wants.
 - b) capital investment.
 - c) 100% reserve banking.
 - d) fractional-reserve banking.
 - e) credit allocation.
- 38.** The most important, most convenient, and most flexible way in which the Federal Reserve affects the supply of bank reserves is through:
- a) changing the Federal Reserve discount rate.
 - b) conducting bank examinations.
 - c) conducting open-market operations.
 - d) changing bank reserve requirement ratios.
 - e) changing interest rates.
- 39.** When commercial banks borrow reserves from the Fed, the quantity of reserves in the banking system _____ and ultimately the money supply _____.
- a) increases; does not change
 - b) decreases; decreases
 - c) decreases; decreases
 - d) decreases; increases
 - e) increases; increases

- 40.** During the bank panic of 1930-33, the public withdrew deposits from the bank preferring to hold currency. As a result,:
- a)** bank reserves increased by less than the increase in currency causing the money supply to decrease.
 - b)** bank reserves decrease by an amount equal to the increase in currency causing the money supply to decrease.
 - c)** bank reserves decreased but were offset by an equal increase in currency with no net effect on the money supply.
 - d)** bank reserves decreased by more than the increase in currency causing the money supply to decrease.
 - e)** bank reserves decreased by less than the increase in currency causing the money supply to increase.
- 41.** Money serves as a basic yardstick for measuring economic value (i.e., a unit of account), allowing:
- a)** goods and services to be exchanged with a double coincidence of wants.
 - b)** easy comparison of the relative prices of goods and services.
 - c)** people to hold their wealth in a liquid form.
 - d)** private money to be issued for local use.
 - e)** governments to restrict the issuance of private monies.
- 42.** Banks hold reserves:
- a)** to increase profits.
 - b)** only because the government requires them to hold reserves.
 - c)** to meet depositor withdrawals and payments.
 - d)** to earn interest.
 - e)** to escape the double coincidence of wants.
- 43.** If consumption spending decreases by \$5 million with no changes in net transfer payments, then:
- a)** private saving increases.
 - b)** private saving decreases.
 - c)** private saving does not change.
 - d)** public saving increases.
 - e)** public saving decreases.
- 44.** The money supply in Econland is 1,500, and currency held by the public equals bank reserves. The desired reserve/deposit ratio is 0.20. Bank reserves equal ____.
- a)** 1500
 - b)** 500
 - c)** 200
 - d)** 300
 - e)** 250

- 45.** If banks' desired reserve ratio increases from .10 to .15, the public still desires to hold the same amount of currency, and the Fed takes no actions, the money supply will:
- a)** either increase or decrease.
 - b)** equal the quantity of currency that is still in use.
 - c)** decrease.
 - d)** not change.
 - e)** increase.

Answer Key

1. c
2. b
3. d
4. e
5. c
6. b
7. b
8. d
9. b
10. e
11. d
12. c
13. d
14. e
15. d
16. d
17. a
18. d
19. c
20. d
21. e
22. b
23. e
24. b
25. e
26. c
27. d
28. e
29. e
30. b
31. e
32. a
33. a
34. b
35. b
36. a
37. d
38. c
39. e
40. b
41. b
42. c
43. a
44. e
45. c

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Short-Essay Question (10 points)

Answer in the given space below each question.

“A high rate of money growth generally leads to inflation.”

- A. Using the quantity equation, show that the rate of growth of the money supply equals the rate of inflation.
- B. Now, if you are in charge of the Federal Reserve System, what are the three tools that you can use to change the money supply?
- C. What would the Fed do with each tool if it wanted to increase the money supply?

Solution

- A. Quantity Equation $M \times V = P \times Y$
If V and Y are constant, then the percentage increase in the money supply leads to the same percentage increase in the price level.
- B. Open market operations, the reserve requirement, and discount window lending.
- C. Make open market purchases, lower the reserve requirement, lower the discount rate to increase discount window lending.