

ANSWER OUTLINE

ECONOMICS 353
FINAL EXAM: 70 Questions Total (1 Point Each)

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Please write on side 1 of your answer bubble sheet your **FIRST AND LAST NAME** together with your **STUDENT ID NUMBER**, and write **ECON 353: FINAL EXAM** on the top margin of side 1.

Answer all 70 questions below by marking answers on your answer bubble sheet using a number 2 pencil ****ONLY****. Each question is worth 1 point. Read each question carefully before answering.

USE OF ANY ELECTRONIC OR MECHANICAL DEVICE (E.G., CALCULATORS) DURING THE EXAM IS STRICTLY PROHIBITED.

Questions Q1-Q29 focus on required materials covered on the first and second midterms, questions Q30-Q58 focus on required materials since the second midterm, and questions Q59-70 focus on several real-world applications discussed in the Q6 portions of take-home exercise assignments and in required readings and class lectures.

At the end of the exam, please turn in your bubble sheet and be prepared to show an official photo ID of yourself (e.g., student ID, driver's license) if asked.

CAUTION: Do your own work, do not assist others in any way during the exam, and keep your eyes focused only on your own exam. Any behavior to the contrary will be considered cheating and will not be tolerated. Cheating will result in an automatic F on the exam, and further sanctions may be applied in line with university policy.

****OPPORTUNITY TO COMMENT ON QUESTIONS:**** If you wish to comment on a question you believe is unclear or ambiguous, please do the following:

(1) Write your specific comments on the following pages along side the statement(s) of the question(s) about which you have concerns.

(2) Indicate here the numbers of the questions you have commented on:

(3) Write your name and student ID number where indicated below.

STUDENT NAME _____

STUDENT ID NUMBER _____

(4) At the end of the exam, give this exam question packet to the instructor for special handling.

- Q1.** The U.S. government agency that regulates security markets to ensure participants adhere to standard accounting principles and properly disclose information is
- A. the Securities Supervision and Accountancy Board.
 - B. the Federal Deposit Insurance Corporation.
 - C. the Federal Reserve.
 - D. the Securities and Exchange Commission.
- Q2.** The primary function of the U.S. Federal Reserve System is to
- A. conduct U.S. monetary policy, i.e. the management of money and interest rates.
 - B. oversee the printing and security of U.S. currency.
 - C. insure bank deposits and impose restrictions on the assets banks can hold.
 - D. oversee the federal chartering of commercial banks and savings and loan associations.
- Q3.** According to time series data presented in Mishkin (Chapter 1) and in class:
- A. the supply of money (M2) tends to fluctuate in the OPPOSITE direction of the aggregate price level (i.e. when one is increasing the other tends to be decreasing, and vice versa).
 - B. the supply of money (M2) tends to fluctuate INDEPENDENTLY of the aggregate price level because of its breadth.
 - C. the supply of money (M2) tends to fluctuate in the SAME direction as the aggregate price level (i.e. when one is increasing the other tends to be increasing, and vice versa)
 - D. a HIGH average inflation rate is associated with a LOW average money growth rate, and vice versa.
- Q4.** By definition (Mishkin Chapter 1, Appendix), the growth rate for any variable V from time period T-1 to time period T is given by
- A. $100 \times [V(T) - V(T - 1)]$
 - B. $100 \times [V(T) + V(T - 1)]/2$
 - C. $100 \times [V(T + 1)/V(T)]$
 - D. $100 \times [V(T) - V(T - 1)]/V(T - 1)$
- Q5.** By definition (Mishkin Chapter 1, Appendix), the qualifier “nominal” applied to U.S. Gross Domestic Product (GDP) implies that
- A. the value of the GDP is measured in current prices.
 - B. the value of the GDP is measured in base-year prices.
 - C. the current value of the GDP is only approximate and will subsequently be revised when more data become available.
 - D. The value of the GDP excludes real (tangible) assets.

- Q6.** By definition, attributes SHARED by financial intermediaries (FIs) and dealers include:
- A.** both engage in asset transformation.
 - B.** both “make the market” for various stocks and bonds by setting their purchase and sale prices.
 - C C.** both earn profits from financial asset purchases and sales by “buying low” and “selling high”.
 - D.** neither one holds inventories of the financial assets in which they trade.
- Q7.** Which of the following markets are organized as OVER-THE-COUNTER markets:
- A A.** The Nasdaq stock market
 - B.** U.S. Treasury auctions.
 - C.** The New York Stock Exchange
 - D.** All of the above.
- Q8.** As discussed in Mishkin (Chapter 2), the FEDERAL FUNDS RATE is the interest rate on
- A.** bonds issued by the Federal government.
 - B.** loans made by the Federal Reserve System to banks.
 - C C.** overnight loans between banks of their deposits at the Federal Reserve.
 - D.** loans made by banks to the Federal Reserve System.
- Q9.** A LENDER acquires ____ by _____.
- A A.** a contractually promised payment stream; buying a newly issued debt instrument.
 - B.** a contractually promised payment stream; issuing and selling a debt instrument.
 - C.** temporary additional purchasing power; issuing and selling a debt instrument.
 - D.** immediate loan principal (funds); buying a newly issued debt instrument.
- Q10.** By definition, DIRECT FINANCE refers to
- A.** trades of financial assets enacted directly (immediately) in a spot market rather than in a forward market.
 - B.** trades of financial assets enacted directly (face to face) between buyers and sellers.
 - C C.** instances of borrowing in which borrowers directly transact with their lenders.
 - D.** instances of borrowing mediated directly by a financial intermediary.

Q11. Which of the following properties characterize CORPORATE DEBT SECURITIES:

- A.** Corporate debt holders regularly participate in key management decisions of their corporate debt issuers.
- B.** In case of bankruptcy, corporate debt claims are paid before corporate equity claims.
- C.** Corporate debt payments are not conditional on the profits earned by the debt issuer except under conditions of duress.
- D D.** Both B and C above.

Q12. Which of the following properties characterize COMMON STOCK SHARES:

- A.** If bankruptcy occurs, common stock holder claims are paid after preferred stock holder claims.
- B.** Holders of a corporation's common stock shares have the right to vote their approval or disapproval of key corporate management decisions.
- C.** By law, corporations must pay out their profits as dividends to their common stock holders within a reasonable amount of time.
- D.** All of the above.
- E E.** Only A and B.

Q13. By definition, a form of money is said to be LEGAL TENDER if

- A A.** it is required by law to be accepted for repayment of debts.
- B.** the issuer has received a charter from government.
- C.** it is required by law to be accepted for the purchase of goods and services.
- D.** it is issued by a government.

Q14. By definition, a form of money is said to be FIAT if

- A.** it is required by law to be accepted for the repayment of debts.
- B.** it is required by law to be accepted for the purchase of goods and services.
- C C.** it is a paper money that is unbacked legal tender.
- D.** it is token coinage issued by a government.

Q15. M1 exemplifies the ____ approach to measuring money in that _____

- A.** empirical; M1 is a selection of financial assets judged best for controlling GDP growth.
- B.** empirical; M1 is a weighted aggregate (average) of all of the most widely held financial assets.
- C C.** theoretical; M1 is a selection of financial assets judged to most closely satisfy the definition of money.
- D.** theoretical; M1 is a weighted aggregate (average) of all financial assets acting to some degree as a medium of exchange.

- Q16.** Which of the following typically take the form of FIXED-PAYMENT LOANS:
- A. Installment loans with finance companies.
 - B. Residential mortgages.
 - C. Newly issued corporate bonds.
 - D. All of the above.
 - E E. Only A and B.
- Q17.** The COUPON RATE on a coupon bond with a purchase price of \$100, a \$90 face value, annual coupon payments of \$15, and a 2-year maturity is defined to be
- A. total coupon payments \$30 divided by the maturity 2.
 - B. the coupon payment \$15 divided by the purchase price \$100.
 - C C. the coupon payment \$15 divided by the face value \$90.
 - D. one coupon payment per year.
- Q18.** Which of the following statements are true for a DISCOUNT BOND with a face value F:
- A. Treasury bills take this form.
 - B. The purchase price is usually less than F.
 - C. The interest rate (yield to maturity) is always zero.
 - D. All of the above.
 - E E. Only A and B above.
- Q19.** The PRESENT VALUE concept ____.
- A. provides an accurate assessment for future interest rate risk.
 - B. measures the implicit discount rate used by the market to price assets.
 - C. provides an accurate assessment of an asset's real purchasing power.
 - D D. permits payment streams on different financial assets to be compared with each other in terms of a common unit of account.
 - E. provides a way to measure the current value of a financial asset without having to consider the timing and amount of future payments.

- Q20.** All else equal, a coupon bond's current yield is a MORE accurate measure of its yield to maturity the ____ the bond's maturity and the _____ of its purchase price from its face value.
- A. longer; greater the deviation
 - B B. longer; smaller the deviation
 - C. shorter; smaller the deviation
 - D. shorter; greater the deviation
- Q21.** If each of the following coupon bonds has a face value \$4000, which has the HIGHEST yield to maturity?
- A. A coupon bond with a 3% coupon rate and a purchase price \$4,000
 - B. A coupon bond with a 5% coupon rate and a purchase price \$4,000
 - C C. A coupon bond with an 8% coupon rate and a purchase price \$4,000
 - D. A coupon bond with an 8% coupon rate and a purchase price \$4,500
- Q22.** INTEREST RATE RISK is the risk faced by ____ in the form of ____.
- A. a person contemplating a bond purchase; fluctuations in the real interest rate on bonds.
 - B B. a person who has already bought a bond; uncertainty regarding the bond's return rate due to possible fluctuations in the bond's yield to maturity during the holding period.
 - C. a person who has already issued and sold a bond; fluctuations in the interest payments the bond issuer will have to make to the bond purchaser.
 - D. a person who is contemplating the issue and sale of a bond; fluctuations in the nominal interest rate on bonds.
- Q23.** By definition, the REAL INTEREST RATE is
- A. the nominal (market) interest rate corrected for interest rate risk.
 - B. the nominal (market) interest rate on real assets.
 - C. the nominal (market) interest rate plus the inflation rate.
 - D D. the nominal (market) interest rate minus the inflation rate.

- Q24.** Interest and principal payments for TREASURY INFLATION PROTECTION SECURITIES (TIPS) are adjusted for _____, which implies that ____.
- A. changes in default risk; TIPS earn a constant real interest rate.
 - B. changes in the inflation rate; TIPS can be bought and sold at a fixed (pegged) price.
 - C C. changes in the price level; the interest rate on TIPS provides a direct measure of the real interest rate.
 - D. changes in the money supply; TIPS help government to ensure a balanced budget.
- Q25.** Letting i denote the yield to maturity on coupon bonds, which situation below should a rational LENDER prefer to be in if he is planning to purchase a newly issued coupon bond?
- A. $i = 2$ percent and the expected inflation rate = -2 percent
 - B. $i = 12$ percent and the expected inflation rate = 10 percent
 - C. $i = 8$ percent and the expected inflation rate = 9 percent
 - D D. $i = 6$ percent and the expected inflation rate = 1 percent
- Q26.** A key DISTINCTION between the YIELD TO MATURITY and the RETURN RATE on a financial asset is
- A. the yield to maturity assumes a financial asset will be held to maturity, whereas the return rate can be calculated for any holding period.
 - B. the yield to maturity ignores capital gains or losses that might accrue to an investor who sells a financial asset prior to its maturity, whereas the return rate does not.
 - C. the return rate takes all payments into account over the entire maturity of the financial asset, whereas the yield to maturity does not.
 - D. all of the above.
 - E E. Only A and B above.
- Q27.** Consider a coupon bond with an annual coupon payment $C = \$100$, a face value $F = \$3,000$, and a maturity date January 1, 2012. Suppose you BUY this bond on January 1, 2007 for $P_b = \$2500$ and you SELL it on January 1, 2008 for $\$3000$. Which of the following statements are TRUE for this bond:
- A. Your (annual) current yield is C/P_b .
 - B. Your return rate is your current yield plus the rate of your capital gain or loss.
 - C. Your return rate is LESS than your current yield.
 - D. All of the above are true.
 - E E. Only A and B are true.

Q28. Suppose a consol bond pays \$1.00 at 11:59 P.M. on December 31 of each year in perpetuity. Suppose you purchase the consol bond for \$100 at midnight on December 31, 2007, and you sell it for \$109 at midnight on December 31, 2008. Suppose the inflation rate during 2007 is 4 percent. Then your **NOMINAL** return rate on the consol bond for 2007 would be ____ and your **REAL** return rate on the consol bond for 2007 would be ____.

- A. 1 percent; -3 percent
- B B.** 10 percent; 6 percent
- C. 10 percent; 14 percent
- D. 1 percent; 5 percent
- E. 9 percent; 5 percent

Q29 (1 point). Let B denote a bond whose maturity date is $T+1$, and let $i(T)$ denote the yield to maturity on B at time T . Then an **INCREASE** in $i(T)$ at time T results in a ____ in the return rate to B over the holding period from $T-1$ to T because it implies a ____ in the sale price of the bond at time T .

- A. increase; decrease
- B. increase; increase
- D. decrease; increase
- E E.** decrease; decrease

Q30. In a primary bond market, the ____ **DEMAND CURVE** for bonds slopes downward to the right because, at a **LOWER** bond price, _____.

- A. borrowers'; borrowers are encouraged to buy more bonds.
- B. borrowers'; borrowers are encouraged to sell more bonds
- C C.** lenders'; lenders are encouraged to buy more bonds.
- D. lenders'; lenders are encouraged to sell more bonds.

Q31 (1 Point). If there is an **EXCESS DEMAND** for Treasury bonds at the current market price for Treasury bonds, then the theory in Mishkin Chapter 5 predicts that (all else equal) the current market price of Treasury bonds is ____ the equilibrium price and hence will ____.

- A. above; be bid upwards until demand equals supply
- B. above; be bid downwards until demand equals supply
- C C.** below; be bid upwards until demand equals supply
- D. below; be bid downwards until demand equals supply

- Q32 (1 Point).** According to the theory of demand explained in Mishkin (Chapter 5), if the CURRENT PRICE of residential owner-occupied housing suddenly FALLS, then (all else equal) the CURRENT DEMAND for residential owner-occupied housing will ____ and the CURRENT DEMAND CURVE for residential owner-occupied housing ____.
- A. increase; will not shift.
 - B. decrease; shift to the right.
 - C. decrease; will not shift.
 - D. increase; shift to the left.
- Q33 (1 Point).** If the expected inflation rate FOR NEXT YEAR is expected to fall, then (all else equal) this will tend to DISCOURAGE CURRENT ____, in the sense that the ____ for bonds will shift _____.
- A. borrowing; current demand curve; to the left
 - B. lending; current demand curve; to the right
 - C. lending; current supply curve; to the right
 - D. borrowing; current supply curve; to the left
- Q34.** Suppose something suddenly happens that leads investors today to have LOWER expectations concerning the yield to maturity for bonds to be realized ONE YEAR FROM NOW. Then one would expect the current demand curve for bonds to ____ because of _____.
- A. shift left; a lower expected capital gain over the coming year.
 - B. shift right; a higher expected capital gain over the coming year.
 - C. shift left; a higher expected capital gain over the coming year.
 - D. shift right; a lower expected capital gain over the coming year.
- Q35.** In the ONE-PERIOD VALUATION MODEL FOR STOCK SHARES, the current share price of a stock is assumed to equal the discounted value of
- A. all expected future dividend payments accruing to a shareholder
 - B. next period's expected dividend payment plus next period's expected share price.
 - C. next period's expected dividend payment.
 - D. next period's expected share price.

- Q36 (1 Point).** By definition, a PRICE BUBBLE is said to exist for a stock if
- A. the share price of the stock exhibits high volatility over time.
 - B. the share price of the stock differs from the present value of all of the expected future dividend payments to the shareholder.
 - C. the share price of the stock has sharply increased over the past few periods and is now suddenly in sharp decline.
 - D. the share price of the stock is higher than the average share price of all stocks.
- Q37.** In the GENERALIZED DIVIDEND (VALUATION) MODEL described by Mishkin (Chapter 7), the current share price of a stock is assumed to equal
- A. the present value of all of the expected future dividend payments to the shareholder.
 - B. next period's expected dividend payment divided by the required return on equity net of the dividend growth rate.
 - C. the expected future revenues (per shareholder) of the issuing corporation.
 - D. the expected future profits (per shareholder) of the issuing corporation.
- Q38 (1 Point).** The GENERALIZED DIVIDEND (VALUATION) MODEL described by Mishkin (Chapter 7) predicts that a stock that is never expected to pay any dividends
- A. will have a current share price equal to the present value of its face value.
 - B. will have a current share price equal to zero.
 - C. will have a current share price equal to its required return on equity.
 - D. will have a current share price equal to the present value of its expected future share prices.
- Q39.** Expectations formed by taking a weighted average of past observations are known as
- A. perfect foresight expectations.
 - B. adaptive expectations.
 - C. extrapolated expectations.
 - D. rational expectations.
- Q40.** The key assumption characterizing RATIONAL EXPECTATIONS is that
- A. people do not make sudden changes in their expectations.
 - B. people do not make use of past observations because these observations are out-of-date.
 - C. people make optimal use of their information when forming their expectations.
 - D. people are able to forecast things without error.

- Q41.** In its strongest form, the EFFICIENT MARKETS HYPOTHESIS implies
- A. there is no adverse selection in financial markets.
 - B B.** the price of each stock share equals its fundamental value, i.e., the discounted value of its expected future dividend payments.
 - C. the prices of securities cannot exhibit sudden large changes.
 - D. technical analysis is the preferred mode for determining financial investments.

- Q42.** In economics, an ARBITRAGE OPPORTUNITY is said to exist if
- A. regulators are able to increase social welfare by suitably applied rules and regulations.
 - B. a conflict arising between traders can be resolved by an arbitration process.
 - C C.** starting from nothing, people are able to engage in a sequence of transactions from which they can earn positive profits for sure.
 - D. investors have a chance to increase their profits by investing in projects with high expected returns.

****IMPORTANT NOTE:**** Questions 43-58 below assume the world is divided between HC and ROW and that all HC and ROW currency reserves are held by the HC central bank.

- Q43.** Let E denote the HC nominal exchange rate as defined in Mishkin and used in class. If V denotes some amount measured in HC currency units, then multiplying V times E ____.
- A. corrects V for changes in the HC price level.
 - B B.** transforms V into a valuation measured in ROW currency units.
 - C. corrects V for changes in the HC inflation rate.
 - D. transforms V into pure quantity terms.

- Q44.** Letting E denote the HC nominal exchange rate, the HC REAL EXCHANGE RATE is defined to be
- A. E minus the ROW inflation rate.
 - B B.** E multiplied by the HC price level and divided by the ROW price level
 - C. E minus the HC inflation rate.
 - D. E multiplied by the ROW price level and divided by the HC price level.

- Q45.** The HC REAL EXCHANGE RATE measures
- A A.** the price of HC output in terms of ROW output (a goods-for-goods price).
 - B B.** the difference in inflation rates between ROW and HC.
 - C C.** the relative size of net exports in the ROW versus the HC.
 - D D.** the relative amount of currency in the ROW versus the HC.
- Q46.** The PURCHASING POWER PARITY (PPP) CONDITION asserts
- A A.** the HC and ROW have the same aggregate price levels.
 - B B.** the HC and ROW have the same inflation rates.
 - C C.** the HC real exchange rate is equal to one.
 - D D.** the HC nominal exchange rate equals the ROW nominal exchange rate.
- Q47.** The basic motivation for the PURCHASING POWER PARITY (PPP) CONDITION is that, in equilibrium, there should be no opportunities for arbitrage _____.
- A A.** through currency swaps between HC and ROW.
 - B B.** through financial asset trades between HC and ROW.
 - C C.** through HC speculative investment in ROW stocks.
 - D D.** through trades in goods and services between HC and ROW.
- Q48.** The INTEREST PARITY CONDITION assumes that investors carefully consider
- A A.** the risk of default for HC versus ROW deposit accounts.
 - B B.** the interest rate risk for HC versus ROW deposit accounts.
 - C C.** the possible gains or losses due to exchange rate movements while they are holding HC versus ROW deposit accounts.
 - D D.** the moral hazard risk associated with HC versus ROW deposit accounts.
- Q49.** Suppose the nominal interest rate in ROW is 4 percent. Suppose the HC nominal exchange rate is expected to depreciate by 2 percent. Then the INTEREST PARITY CONDITION predicts that the nominal interest rate in the HC should be
- A A.** -2 percent
 - B B.** -6 percent.
 - C C.** 2 percent
 - D D.** 6 percent.

Q50. ROW SAVINGS in relation to the HC is measured as _____, where all amounts are measured in HC currency units.

- A. HC imports minus HC exports
- B. ROW GDP minus ROW consumption
- C C. Total income received by ROW from the HC, minus HC exports
- D. Total income received by the HC from ROW, minus HC imports

Q51. The HC CURRENT ACCOUNT CA keeps track of

- A. net payments received by HC from ROW through trades in financial assets and pre-existing real assets.
- B B. HC net exports + net factor payments to the HC + net transfer payments to the HC
- C. net payments received by the HC from ROW through reserve currency transactions.
- D. net payments received by the HC from ROW through all current-year trades.

NOTE: Questions Q52 and Q54 have been removed because they rely on older (now out of date) accounting conventions for the treatment of financial asset transactions and secondary physical asset transactions in the U.S. Balance of Payments Accounts.

Q53. Which of the items below would be directly entered as an item in the HC CURRENT ACCOUNT:

- A. A ROW citizen's purchase of an HC corporate bond.
- B. HC foreign aid to ROW.
- C. Salaries of HC citizens working for a company in ROW.
- D. Dividend payments received by HC holders of ROW company stock shares.
- E E. All but A.

Q55. The close relation between the HC CURRENT ACCOUNT CA and ROW SAVINGS S_r is evidenced by the following accounting identity, where “*” denotes multiplication:

- A A.** $CA = [-1] * S_r$.
- B.** $CA = S_r$.
- C.** $S_r = CA + KA$, where KA = Capital Account.
- D D.** $CA = S_r + KA$, where KA = Capital Account.

Q56. If the HC is running a CURRENT ACCOUNT DEFICIT, i.e. if $CA < 0$, then HC national savings ____ HC total investment and the HC is ____ ROW.

- A.** is greater than; a net lender to
- B.** is greater than; a net borrower from
- C.** is less than; a net lender to
- D D.** is less than; a net borrower from

Q57. If the HC is in a BALANCE OF PAYMENTS EQUILIBRIUM, this means

- A.** the HC central bank is undertaking official reserve transactions to ensure demand equals supply in the foreign exchange market.
- B B.** ROW currency demand equals ROW currency supply without any need for the HC central bank to buy or sell currency from its currency reserves.
- C.** HC government expenditures are equal to HC tax revenues.
- D.** in net terms the HC is neither borrowing from nor lending to ROW.

- Q58.** In principle, if the HC has a FLEXIBLE NOMINAL EXCHANGE RATE E, this should ensure that
- A.** the HC current account CA is zero.
 - B.** the HC balance of payments BOP is zero.
 - C.** the net change in the currency reserves held by the HC central bank is zero.
 - D.** the sum of the HC current account CA and the “nonofficial” HC capital account NKA equals the balance of payments BOP.
 - E E.** Both B and C.
- Q59.** As seen in Exercise 2 (Q6), a key attribute of many EDUCATION LOANS for U.S. undergraduate students is that collateral is not required. Rather, the primary mechanism used to protect private lenders against student default is
- A.** credit checks of parents.
 - B.** the ability to garnish the wages of the parents of defaulting students.
 - C C.** guarantees against default provided by the U.S. federal government.
 - D.** peer pressure implemented by dividing student borrowers into small peer groups with joint responsibility for repayment of loans.
 - E.** relatively high interest rates.
- Q60.** As discussed in the required syllabus reading “Measuring the Volatility of Stock Returns” accompanying Mishkin Chapter 2:Part A materials, a commonly used quantitative measure of the VOLATILITY of a stock index over a given time period is
- A.** the average magnitude of fluctuations (peak to trough) in the prices of the included stock shares.
 - B B.** the sample standard deviation of the stock index’s daily return rate.
 - C.** the frequency with which the prices of the included stock shares fluctuate up and down.
 - D.** the frequency with which the stock index’s daily return rate fluctuates up and down.
 - E.** the frequency of purchases and sales of the included stock shares.

Q61. As discussed in Exercise 3 (Q6), a key attribute of the NASDAQ Composite Index that appears to explain its high volatility during the dot.com bubble and burst period (1997-2001) is that

- A. it includes a very large number of stocks and hence is more sensitive to shocks.
- B. it includes a highly diversified portfolio of stocks and hence is more sensitive to shocks.
- C. it is heavily tilted towards technology stocks and hence is highly sensitive to technology sector shocks.
- D. it includes only small company (“small cap”) stocks and hence is highly sensitive to shocks affecting start-up companies.

Q62. Prior to 1837, entities wishing to receive a charter from state authorities to enter the U.S. banking industry had to obtain discretionary approval through specific acts introduced into state legislatures, and this approval increasingly was given (or not) for purely political considerations. As discussed in Exercise 4 (Q6), the FREE BANKING ERA (1837-1863) is considered to be an extraordinarily important empirical experiment because, during this period, entities were “freely” allowed to enter the U.S. banking industry

- A. without restriction.
- B. if they satisfied a tightened set of federal regulations.
- C. under the terms of a local community’s general laws of incorporation, with no involvement of state or federal authorities.
- D. under the terms of a state’s general laws of incorporation, with no special state legislative approval required.

Q63. As discussed in Exercise 6 (Q6), FANNIE MAE (the Federal National Mortgage Association) is a _____ whose primary function is _____.

- A. mortgage refinance company; mortgage securitization, meaning it creates publicly tradable securities backed by mortgages that it purchases.
- B. savings and loan association; the issuing of residential mortgages to households.
- C. regulatory agency; oversight and regulation of the U.S. market for residential and commercial mortgages.
- D. government-owned agency; to help residential households to restructure their mortgage loans at lower interest rates when interest rates fall.

- Q64.** As discussed in Exercise 7 (Q6), the WORLD BANK was established in ____ for the primary purpose of _____.
- A.** 1914; supporting the gold standard as countries involved in World War I faced pressures to devalue.
 - B.** 1933; providing emergency loans to households and firms caught up in the Great Depression.
 - C.** 1944; providing loans to European countries to help with their reconstruction after World War II.
 - D.** 1971; supporting the transition to flexible exchange rates following the breakdown of the Bretton Woods Agreement.
 - E.** 1982; providing liquidity loans to third-world countries experiencing financial crises.
- Q65.** As discussed in Exercise 7 (Q6), the primary CURRENT function of the World Bank is to
- A.** act as a lender of last resort to countries experiencing financial crises.
 - B.** provide loans to developing countries (particularly the poorest of these countries) to help with development projects.
 - C.** provide banking services to the international community.
 - D.** oversee monetary policy (management of money and interest rates) for the international community.
 - E.** force countries to undertake needed adjustments to their financial structures.
- Q66.** As discussed in Exercise 8 (Q6), EMPLOYEE STOCK OPTIONS (ESOs) entail potential risks for companies. For example, as seen in the recent Enron disaster,
- A.** company executives receiving large ESO awards have an incentive to induce share price increases through dubious means.
 - B.** company executives receiving large ESO awards have an incentive to retire early.
 - C.** employees receiving large ESO awards no longer have their incentives aligned with company shareholders.
 - D.** companies are legally obligated to report ESOs on their balance sheets as potential payment obligations (costs).
 - E.** employees receiving ESO awards are legally entitled to compensation in case of company bankruptcy.

- Q67.** As discussed in the required online “Notes on Mishkin Chapter 17,” Europe is currently undertaking a grand integration experiment called the EUROPEAN UNION. In particular,
- A.** a European Central Bank has been established to take over monetary policy from the individual central banks of all current member countries of the European Union.
 - B.** 12 of the member countries of the European Union have completely phased out their national currencies and accepted the euro as their only legal tender currency.
 - C.** a European Constitution has been accepted as the constitution governing the political affairs of all current member countries of the European Union.
 - D.** All of the above.
 - E.** Only A and B.
- Q68.** As discussed in Exercise 8 (Q6) and in the required online “Notes on Mishkin Chapter 18,” the INTERNATIONAL MONETARY FUND (IMF) was founded as part of the ____ for the primary purpose of
- A.** 1914 Gold Standard Act; supporting the gold standard as countries involved in World War I faced pressures to devalue.
 - B.** 1935 Reconstruction Act; seeking emergency international loans for U.S. households and firms caught up in the Great Depression.
 - C.** 1944/1945 Bretton Woods Agreement; maintaining fixed exchange rates and making loans to countries experiencing balance of payments difficulties.
 - D.** 1982 Emergency International Relief Act; providing interest-free liquidity loans to third-world countries experiencing financial crises.
- Q69.** The MICROCREDIT movement as exemplified by the Grameen Bank refers to
- A.** the granting of loans to individuals through credit cards rather than through loan contracts.
 - B.** the granting of loans specifically to small businesses (less than 500 employees).
 - C.** the granting of small loans to individuals too poor to have collateral.
 - D.** the granting of small loans to leverage secondary borrowing for productive but risky investments.
- Q70.** A key instrument used by the GRAMEEN BANK and similarly structured microcredit institutions in an attempt to reduce moral hazard problems among their borrowers is
- A.** liens on community assets.
 - B.** strong oversight by government regulators.
 - C.** peer-group borrowing teams jointly responsible for loan repayments.
 - D.** collateral restrictions enforced on extended families.