Practice Question Chapter 23

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

1. Suppose Canada spends more on foreign goods and services than foreigners spend on our goods and services. Then
   A) the rest of the world may or may not finance Canada's trade deficit.
   B) Canada must borrow an amount equal to consumption expenditure plus investment.
   C) Canada must borrow an amount equal to national saving.
   D) Canada must borrow an amount equal to imports minus exports.
   E) none of the above.

2. Suppose that you took out a $1,000 loan in January and had to pay $75 in annual interest. During the year, inflation was 6 percent. Which of the following statements is correct?
   A) The real interest rate is 6 percent and the nominal interest rate is -1.5 percent.
   B) The nominal interest rate is 7.5 percent and the real interest rate is 1.5 percent.
   C) The nominal interest rate is 7.5 percent and the real interest rate is 13.5 percent.
   D) The real interest rate is 6 percent and the nominal interest rate is 7.5 percent.
   E) The real interest rate is 7.5 percent and the nominal interest rate is 1.5 percent.

3. During a recession, firms decrease their profit expectations. As a result, there is a ________ shift of the ________ loanable funds curve.
   A) leftward; demand for loanable funds curve and supply of
   B) rightward; supply of
   C) rightward, supply of
   D) leftward; demand for
   E) rightward; demand for

Refer to the figure below to answer the following questions.

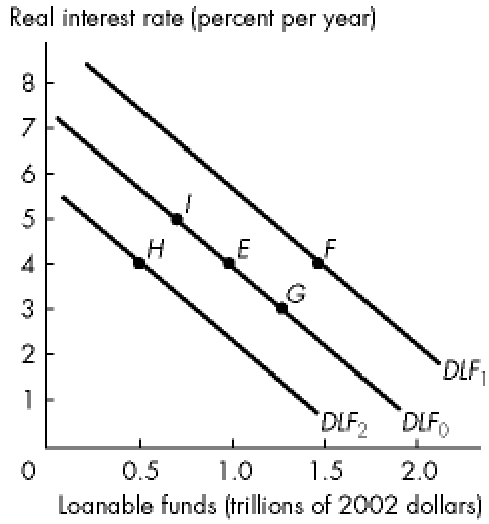

Figure 23.2.2

4. Refer to Figure 23.2.2. In Figure 23.2.2, a decrease in the real interest rate will result in a movement from point *E* to
   A) point *F*.
   B) point *G*.
   C) point *H*.
   D) point *I*.
   E) either point *G* or point *F*.

5. Which of the following influences household saving?
   I. The real interest rate.
   II. Disposable income.
   III. Expected future income.
   A) I and II
   B) I, II, and III
   C) I and III
   D) I only
   E) None of the above

6. The equilibrium real interest rate is determined by the
   A) demand for loanable funds curve and the supply of loanable funds curve.
   B) government expenditure curve and the taxation curve.
   C) demand for loanable funds curve and real GDP.
   D) banks and insurance companies.
   E) supply of loanable funds curve and financial institutions.

7. If the real interest rate is below the equilibrium real interest rate,
   A) lenders are unable to find borrowers willing to borrow all of the available funds and the real interest rate rises.
   B) borrowers are unable to borrow all of the funds they want to borrow and the real interest rate rises.
   C) borrowers are unable to borrow all of the funds they want to borrow and the real interest rate falls.
   D) lenders are unable to find borrowers willing to borrow all of the available funds and the real interest rate falls.
   E) a surplus of loanable funds exists.

8. In Canada's economy, investment is financed by
   A) $S + (T - G) + (M - X)$.
   B) $S + T + M$.
   C) $S + (T - G) + (X - M)$.
   D) $C + I + G + X - M$.
   E) $C + S + T$.

9. The tendency for a government budget deficit to decrease investment is called the
   A) government dissaving effect.
   B) capital investment effect.
   C) deficit effect.
   D) crowding-out effect.
   E) Ricardo-Barro effect.

10. The Ricardo-Barro effect holds that
    A) a government budget deficit crowds out private investment.
    B) a government budget deficit has no effect on the real interest rate.
    C) equal increases in taxes and government expenditures have no effect on equilibrium real GDP.
    D) a government budget deficit induces a decrease in saving that magnifies the crowding out effect.
    E) none of the above.

11. A government budget surplus occurs, which ________ loanable funds. The real interest rate ________, household saving ________, and investment ________.
    A) decreases the demand for; falls; decreases; increases
    B) increases the supply of; falls; increases; decreases
    C) decreases the supply of; decreases; decreases; increases
    D) increases the supply of; falls; decreases; increases
    E) increases the demand for; rises; increases; decreases

12. Real interest rates around the world tend to
    A) be equal because trading partners would not do business otherwise.
    B) differ because inflation rates differ across countries.
    C) be quite different because no two countries are exactly the same.
    D) be equal after adjusting for differences in risk because financial capital seeks the highest possible return.
    E) none of the above.

Refer to the table below to answer the following question.

Table 23.3.2

Real interest rate (percent per year)	Loanable funds demanded (trillions of 2002 dollars)	Loanable funds supplied (trillions of 2002 dollars)
4	8.5	5.5
5	8.0	6.0
6	7.5	6.5
7	7.0	7.0
8	6.5	7.5
9	6.0	8.0
10	5.5	8.5

13. Refer to Table 23.3.2. The table shows an economy's demand for loanable funds and supply of loanable funds schedules when the government's budget is balanced. The quantity of loanable funds demanded increases by $1 trillion at each real interest rate and the quantity of loanable funds supplied increases by $2 trillion at each real interest rate. If the government wants investment to be $9 trillion, it must ________ its budget balance by ________ trillion.
    A) decrease; $1
    B) decrease; $1.5
    C) increase; $2
    D) increase; $1
    E) increase; $1.5

14. A very small country is a net foreign borrower and its demand for loanable funds increases. As a result, the equilibrium quantity of loanable funds used in the country ________ and the country's foreign borrowing ________.
    A) increases; increases
    B) does not change; does not change
    C) increases; decreases
    D) does not change; increases
    E) increases; does not change