

## CHAPTER 9

### SAVING, INVESTMENT AND THE FINANCIAL SYSTEM

1. If you were to start a business delivering documents, you might need to purchase cell phones, bicycles, desks, and chairs.
  - a. These purchases are called capital investment. If you raise the funds from others to purchase them you are a saver.
  - b. These purchases are called capital investment. If you raise the funds from others to purchase them you are a borrower.
  - c. These purchases are called consumption. If you raise the funds from others to purchase them you are a saver.
  - d. These purchases are called consumption. If you raise the funds from others to purchase them you are a borrower.
2. Institutions that help to match one person's saving with another person's investment are collectively called the
  - a. Federal Reserve system.
  - b. banking system.
  - c. monetary system.
  - d. financial system.
3. Most entrepreneurs do not have enough money of their own to start their businesses. When they acquire the necessary funds from someone else,
  - a. their consumption expenditures are being financed by someone else's saving.
  - b. their consumption expenditures are being financed by someone else's investment.
  - c. their investments are being financed by someone else's saving.
  - d. their saving is being financed by someone else's investment.
4. The economy's two most important financial markets are
  - a. the investment market and the saving market.
  - b. the bond market and the stock market.
  - c. banks and the stock market.
  - d. financial markets and financial institutions.
5. Which of the following is a financial-market transaction?
  - a. A saver buys shares in a mutual fund.
  - b. A saver deposits money into a credit union.
  - c. A saver buys a bond a corporation has just issued so it can purchase capital.
  - d. None of the above is correct.
6. A certificate of indebtedness that specifies the obligations of the borrower to the holder is called a
  - a. bond.
  - b. stock.
  - c. mutual fund.
  - d. All of the above are correct.
7. If Proctor and Gamble sells a bond it is
  - a. borrowing directly from the public.
  - b. borrowing indirectly from the public.
  - c. lending directly to the public.
  - d. lending indirectly to the public.
8. Which of the following statements is correct?
  - a. The total income in the economy that remains after paying for consumption and government purchases is called *private saving*.
  - b. The sum of private saving and national saving is called *public saving*.
  - c. For a closed economy, the sum of private saving and public saving must equal investment.
  - d. For a closed economy, the sum of consumption, national saving, and taxes must equal GDP.
9. In national income accounting, we use which of the following pairs of terms interchangeably?
  - a. "investment" and "private saving"
  - b. "investment" and "purchases of stocks and bonds"
  - c. "saving" and "national saving"
  - d. "public saving" and "government tax revenue minus government spending"
10. Which of the following equations represents GDP for a closed economy?
  - a.  $Y = C + I + G + T$
  - b.  $S = I - G$

- c.  $I = Y - C + G$
  - d.  $Y = C + I + G$
11. In a small closed economy investment is \$20 billion and private saving is \$22 billion. What are public saving and national saving?
    - a. \$24 billion and \$2 billion
    - b. \$20 billion and -\$2 billion
    - c. \$2 billion and \$24 billion
    - d. -\$2 billion and \$20 billion
  12. According to the definitions of private and public saving, if  $Y$ ,  $C$ , and  $G$  remained the same, an increase in taxes would
    - a. raise both private and public saving.
    - b. raise private saving and lower public saving.
    - c. lower private saving and raise public saving.
    - d. lower private and public saving.
  13. Suppose that in a closed economy GDP is equal to 11,000, taxes are equal to 1,500, consumption equals 7,500, and government purchases equal 2,000. What is national saving?
    - a. -500
    - b. 0
    - c. 1,500
    - d. None of the above is correct.
  14. Suppose that in a closed economy GDP is 11,000, consumption is 7,500, and taxes are 2,000. What value of government purchases would make national savings equal to 1,000 and at that value would the government have a deficit or surplus?
    - a. 2,500, deficit
    - b. 2,500, surplus
    - c. 1,000, deficit
    - d. 1,000, surplus
  15. For a closed economy, GDP is \$11 trillion, consumption is \$7 trillion, taxes are \$3 trillion and the government runs a surplus of \$1 trillion. What are private saving and national saving?
    - a. \$4 trillion and \$1 trillion, respectively
    - b. \$4 trillion and \$5 trillion, respectively
    - c. \$1 trillion and \$2 trillion, respectively
    - d. \$1 trillion and \$1 trillion, respectively
  16. If in a closed economy  $Y = \$11$  trillion, which of the following combinations would be consistent with national saving of \$2.5 trillion?
    - a.  $C = \$8$  trillion,  $G = \$5$  trillion
    - b.  $C = \$6.5$  trillion,  $G = \$3$  trillion
    - c.  $C = \$8.5$  trillion,  $G = \$2$  trillion
    - d.  $C = \$9$  trillion,  $G = \$5$  trillion
  17. In the small closed economy of San Lucretia, the currency is the denar. Statistics for last year show that private saving was 60 billion denars, taxes were 70 billion denars, government purchases of goods and services were 80 billion denars, there were no transfer payments by the government, and GDP was 400 billion denars. What were consumption and investment in San Lucretia?
    - a. 270 billion denars, 50 billion denars
    - b. 260 billion denars, 60 billion denars
    - c. 250 billion denars, 70 billion denars
    - d. None of the above is correct.
  18. In examining the national income accounts of the closed economy of Nepotocracy you see that this year it had taxes of \$100 billion, transfers of \$40 billion, and government purchases of goods and services of \$80 billion. You also notice that last year it had private saving of \$50 billion and investment of \$70 billion. In which year did Nepotocracy have a budget deficit of \$20 billion?
    - a. this year and last year
    - b. this year but not last year
    - c. last year but not this year
    - d. neither this year nor last year
  19. The country of Cedarland does not trade with any other country. Its GDP is \$20 billion. Its government purchases \$3 billion worth of goods and services each year, collects \$6 billion in taxes, and provides \$2 billion in transfer payments to households. Private saving in Cedarland is \$4 billion. What is investment in Cedarland?
    - a. \$5 billion
    - b. \$4 billion

- c. \$3 billion
  - d. \$2 billion
20. If the tax revenue of the federal government exceeds spending, then the government necessarily
- a. runs a budget deficit.
  - b. runs a budget surplus.
  - c. runs a national debt.
  - d. will increase taxes.
21. The Eye of Horus incense company has \$10 million in cash which it has accumulated from retained earnings. It was planning to use the money to build a new factory. Recently, the rate of interest has increased. The increase in the rate of interest should
- a. not influence the decision to build the factory because The Eye of Horus doesn't have to borrow any money.
  - b. not influence the decision to build the factory because its stockholders are expecting a new factory.
  - c. make it more likely that The Eye of Horus will build the factory because a higher interest rate will make the factory more valuable.
  - d. make it less likely that The Eye of Horus will build the factory because the opportunity cost of the \$10 million is now higher.
22. Fred is considering expanding his dress shop. If interest rates rise he is
- a. less likely to expand. This illustrates why the supply of loanable funds slopes downward.
  - b. more likely to expand. This illustrates why the supply of loanable funds slopes upward.
  - c. less likely to expand. This illustrates why the demand for loanable funds slopes downward.
  - d. more likely to expand. This illustrates why the demand for loanable funds slopes upward.
23. If the quantity of loanable funds supplied exceeds the quantity of loanable funds demanded,
- a. there is a surplus and the interest rate is above the equilibrium level.
  - b. there is a surplus and the interest rate is below the equilibrium level.
  - c. there is a shortage and the interest rate is above the equilibrium level.
  - d. there is a shortage and the interest rate is below the equilibrium level.
24. If the demand for loanable funds shifts to the right, then the equilibrium interest rate
- a. and quantity of loanable funds rise.
  - b. and quantity of loanable funds fall.
  - c. rises and the quantity of loanable funds falls.
  - d. falls and the quantity of loanable funds rises.
25. What would happen in the market for loanable funds if the government were to decrease the tax rate on interest income?
- a. The supply of loanable funds would shift rightward and investment would increase.
  - b. The supply of loanable funds would shift leftward and investment would decrease.
  - c. The demand for loanable funds would shift rightward and investment would increase.
  - d. The demand for loanable funds would shift leftward and investment would decrease.
26. If in the past Congress had taken additional actions to make saving more rewarding, then today it is likely that the equilibrium interest rate
- a. and the equilibrium quantity of loanable funds both would be lower.
  - b. and the equilibrium quantity of loanable funds both would be higher.
  - c. would be higher and the equilibrium quantity of loanable funds would be lower.
  - d. would be lower and the equilibrium quantity of loanable funds would be higher.
27. Other things the same, a government budget deficit
- a. reduces public saving, but not national saving.
  - b. reduces national saving, but not public saving.
  - c. reduces both public and national saving.
  - d. reduces neither public saving nor national saving.
28. If a reform of the tax laws encourages greater saving, the result would be
- a. higher interest rates and greater investment.
  - b. higher interest rates and less investment.
  - c. lower interest rates and greater investment.
  - d. lower interest rate and less investment.
29. In the first part of this decade the U.S. government went from a surplus to a deficit. Other things the same, this means the
- a. supply of loanable funds shifted to the right.
  - b. supply of loanable funds shifted to the left.
  - c. demand for loanable funds shifted to the right.
  - d. demand for loanable funds shifted to the left.

30. Suppose government expenditures on goods and services increase, transfers are unchanged, and taxes rise by less than the increase in expenditures. These changes in the government's budget cause
- a. both the equilibrium interest rate and the equilibrium quantity of loanable funds to fall.
  - b. both the equilibrium interest rate and the equilibrium quantity of loanable funds to rise.
  - c. the equilibrium interest rate to rise and the equilibrium quantity of loanable funds to fall.
  - d. the equilibrium interest rate to fall and the equilibrium quantity of loanable funds to rise.