

ANSWER OUTLINE

ECONOMICS 353

L. Tesfatsion/Fall 07

EXERCISE 11: 8 Questions (8 Points Total)

DUE: Tues, Dec 4, 2007, 2:10pm

****IMPORTANT REMINDER: LATE ASSIGNMENTS WILL NOT BE ACCEPTED
– NO EXCEPTIONS****

EXERCISE INSTRUCTIONS:

- (1) Please **fill in your name and student ID number** on Side 1 of your bubble sheet and write **353 Exercise 11** in the top margin of Side 1.
- (2) Use a number 2 pencil to **mark your answers on Side 1 of the bubble sheet to all eight questions Q1 through Q8, below**, which are in multiple choice format. There is no Web Exercise question for Exercise 11.
- (3) Each question Q1 through Q8 is worth 1 point.

Q1. According to Mishkin Chapter 8, during 1970-2000 ____ was a more important source of EXTERNAL FUNDS for U.S. corporations than ____.

- A. revenues from stock and bond issues; loans from financial intermediaries
- B. loans from foreign financial intermediaries; loans from domestic financial intermediaries
- C C.** loans from financial intermediaries; revenues from stock and bond issues
- D. loans from government agencies; loans from financial intermediaries

Q2. Some of the key reasons why banks and other financial intermediaries are able to reduce or eliminate information problems and transaction costs include:

- A. banks can spread their loan costs over large pools of depositors (lenders).
- B. bank loans are typically made in private, which gives bankers a greater incentive to engage in costly information gathering.
- C. banks can include collateral requirements in loan contracts, which can act as a signal regarding the type of borrower (high or low risk).
- D D.** all of the above.

Q3. Corporate BONDholders are generally LESS likely to be concerned about moral hazard problems than corporate SHAREholders because

- A.** corporate bondholders have priority over stockholders in case of bankruptcy.
- B.** corporate bonds include restrictive covenants that condition payments on corporate profit performance.
- C.** corporate bond payments are not conditioned on corporate profit performance (except in extreme circumstances such as bankruptcy).
- D.** both A and B.
- E.** both A and C.

Q4. PRINCIPAL-AGENT PROBLEMS are said to occur in financial markets when

- A.** ownership of assets is separated from the control of these assets.
- B.** people who do not pay for information take advantage of the information that other people have paid for by observing their behavior.
- C.** high-risk borrowers are successfully able to pass themselves off as low-risk borrowers when applying for loans.
- D.** the cost per dollar loaned declines as the size of the loan increases.

Q5. The SARBANES-OXLEY ACT OF 2002, introduced in the wake of ____, increased supervisory oversight by ____.

- A.** the dot.com bubble burst; giving Congress the authority to review independent audits of initial public offerings (IPOs).
- B.** the demise of the Arthur Andersen company due to the Enron crisis; establishing the Public Company Accounting Oversight Board to supervise accounting firms and ensure independent audits.
- C.** the U.S. savings and loan crisis; creating a new Department of Conflict Resolution within the Federal Deposit Insurance Corporation (FDIC).
- D.** the U.S. twin deficit problem; directing the General Accounting Office to provide yearly detailed reports on U.S. fiscal expenditures.

- Q6.** The ECONOMIC GROWTH of a country refers to ____.
- A.** changes in its balance of payments.
 - B.** changes in the infrastructure, organization, and governance of its economy.
 - C.** changes in its money supply.
 - D D.** changes in the size of its economy, often measured by changes in GDP.
- Q7.** According to Mishkin Chapter 8, most U.S. FINANCIAL CRISES have begun with one or more of the following “trigger events”:
- A.** a rise in interest rates.
 - B.** a decline in the stock market.
 - C.** a deterioration in banks’ balance sheets.
 - D.** an increase in uncertainty resulting, for example, from a failure of a prominent financial or nonfinancial institution.
 - E E.** all of the above
- Q8.** According to Mishkin Chapter 8, a key way in which U.S. financial crises have DIFFERED from financial crises in emerging economies such as Mexico is that
- A.** U.S. regulators have not permitted insolvent financial institutions to stay in operation.
 - B B.** foreign exchange crises (e.g., speculative currency attacks) have not played a dominant role in U.S. financial crises.
 - C.** U.S. financial crises tend to be of far shorter duration.
 - D.** U.S. financial crises have not resulted in substantial bank failures.