

ANSWER OUTLINE

ECONOMICS 353

L. Tesfatsion/Fall 06

EXERCISE 7: Six Questions (8 Points Total) DUE: Tuesday, Oct. 17, 2006, 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-Ex7** 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 the first five questions Q1 through Q5, below, which are in multiple choice format.
- (3) The sixth question Q6 is a Web Exercise that asks you to explore the organizational structure of the World Bank as well as controversies that have arisen regarding its mode of operation. Please put your **name and student ID number** at the top of your print-out sheet for Q6 along with **353-Ex7:Q6** and **separately** hand in this print-out sheet for Q6 in addition to your answer bubble sheet for questions Q1 through Q5.
- (4) Each question Q1 through Q5 is worth 1 point, and Q6 is worth 3 points.

Q1 (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 any holder of B at time t who chooses to sell B at time t would receive a _____ over the holding period from $t-1$ to t .

- A. increase; smaller capital gain (or larger capital loss)
- B. decrease; smaller capital gain (or larger capital loss)
- C. increase; larger capital gain (or smaller capital loss)
- D. decrease; larger capital gain (or smaller capital loss)

Q2 (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. decrease; shift to the right.
- B. decrease; will not shift.
- C. increase; will not shift.
- D. increase; shift to the left.

Q3 (1 Point). If there is an EXCESS DEMAND of 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

Q4 (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 D. borrowing; current supply curve; to the left

Q5 (1 Point). If the bond market is currently in a demand=supply equilibrium, and suddenly Ben Bernanke at the Fed announces that he has good reason to believe that the yield to maturity on bonds will be HIGHER NEXT YEAR than currently anticipated, then the analysis in Mishkin Chapter 5 predicts that (all else equal) the effect on the CURRENT bond market will be that the ____ for bonds will shift _____ and the CURRENT PRICE of bonds will _____.

- A. current demand curve; to the right; fall
- B B. demand; to the left; fall
- C. current demand curve; to the right; rise
- D. current supply curve; to the right; rise
- E. none of the above

**SEE THE FOLLOWING PAGE FOR
Q6: WEB EXERCISE**

Q6: Web Exercise (3 Points). Why is the World Bank So Controversial?

Key On-Line Reference:

[1] The World Bank Homepage, <http://www.worldbank.int/>

[2] The World Bank Group Homepage, <http://www.worldbankgroup.org/>

In recent years the organizational structure and operating mode of the World Bank have come under scrutiny in response to a growing opposition to its financing activities by certain groups and commentators. This question asks you to consider carefully the nature of this opposition in relation to the intended current purposes of the World Bank.

Note on Terminology: As clarified at the World Bank Group Homepage, the World Bank Group currently consists of five closely associated institutions, including the **International Bank for Reconstruction and Development (IBRD)** and the **International Development Association (IDA)**. The term “World Bank” refers specifically to the IBRD and IDA.

PART A (1/2 Point): When was the World Bank established, and for what purpose? What kinds of activities did it carry out in the years immediately following its establishment? Explain briefly but carefully.

Answer Outline for Q6:Part A As detailed at the World Bank home page, the World Bank was established as part of the Bretton Woods Agreement (July 1944) for the purpose of helping to rebuild Europe after World War II. In the years immediately following its establishment, the World Bank made loans to European countries (e.g. to France) for post-war reconstruction.

PART B (1/2 Point): Briefly but carefully explain the main types of activities currently carried out by the IBRD and the IDA.

Answer Outline for Q6:Part B As detailed at the World Bank home page:

1. **IBRD:** “IBRD lending to developing countries is primarily financed by selling AAA-rated bonds in the world’s financial markets. While IBRD earns a small margin on this lending, the greater proportion of its income comes from lending out its own capital. This capital consists of reserves built up over the years and money paid in from the bank’s 184 member country shareholders. IBRDs income also pays for World Bank operating expenses and has contributed to IDA and debt relief.”
2. **IDA:** “IDA, the world’s largest source of interest-free loans and grant assistance to the poorest countries, is replenished every three years by 40 donor countries. Additional funds are regenerated through repayments of loan principal on 35-to-40-year, no-interest loans, which are then available for re-lending. IDA accounts for nearly 40% of our lending.”

PART C (2 Points): Three primary types of criticisms directed at the World Bank in recent years are briefly indicated below. Choose ONE of these criticisms and explain briefly but carefully:

- (a) which key commentators/groups are making this criticism, and to which World Bank institution(s) is it directed;
- (b) what, more specifically, is the nature of the criticism;
- (c) what evidence is provided in support of the criticism;
- (d) to what extent do you find this evidence compelling.

Three Criticisms of the World Bank (choose only ONE to discuss):

- [I] “The World Bank undermines the national sovereignty of recipient countries by forcing countries to undertake structural adjustment programs.”
- [II] “Certain countries (notably the U.S.) exert strong political influence over the operations of the World Bank in order to advance their own interests.”
- [III] “The World Bank intervenes in order to salvage irresponsible loans from private institutions to corrupt and non-representative governments in developing countries, thus shifting the the risk from the original private lenders to tax-payers in the richest member countries.”