Week 5 Tutorial Solution
ECON203: Macroeconomics 2
Dr. Lei Pan — Semester 2, 2019
Australian Catholic University — Tutorial Time: 30/08/2019

Multiple Choice Questions

Question 1. The relationship between stock prices and firms' investments in physical capital is captured by what theory?
(a) User-cost-of-capital theory
(b) q theory
(c) Yield-curve theory
(d) Keynesian theory

Answer: B

Question 2. Tobin's q is equal to
(a) the ratio of capital's market value to its replacement cost.
(b) the ratio of capital's replacement cost to its market value.
(c) the expected after-tax real interest rate.
(d) the stock market value of a firm.

Answer: A

Question 3. If the stock market value of a firm is \$10 million and the firm owns \$15 million of capital, then Tobin's q equals
(a) 2/3.
(b) 1.
(c) 3/2.
(d) 4.

Answer: A

Question 4. A firm should invest more if Tobin's q
(a) equals zero.
(b) is less than one.
(c) equals one.
(d) is more than one.

Answer: D

Question 5. A technological improvement will
(a) increase the desired capital stock.
(b) decrease the desired capital stock.
(c) have no effect on the desired capital stock.
(d) have the same effect on the desired capital stock as an increase in corporate taxes.

Answer: A

Question 6. Suppose your company is in equilibrium, with its capital stock at its desired level. A permanent decline in the expected real interest rate now has what effect on your desired capital stock?
(a) Raises it, because the future marginal productivity of capital is higher
(b) Lowers it, because the future marginal productivity of capital is lower
(c) Raises it, because the user cost of capital is now lower
(d) Lowers it, because the user cost of capital is now higher

Answer: C

Question 7. What is the difference between gross investment and net investment?
(a) Net investment = gross investment minus taxes
(b) Net investment = gross investment minus net factor payments
(c) Net investment = gross investment minus inventory accumulation
(d) Net investment = gross investment minus depreciation

Answer: D

Question 8. In 2003, your firm's capital stock equaled $10 million, and in 2004 it equaled $15 million. The average depreciation rate on your capital stock was 20%. Net investment in 2004 equaled
(a) $3 million.
(b) $4 million.
(c) $5 million.
(d) $7 million.

Answer: C

Question 9. Any change in the economy that raises desired national saving for a given value of the real interest rate will shift the desired national saving curve to
(a) the right and increase the real interest rate.
(b) the right and decrease the real interest rate.
(c) the left and increase the real interest rate.
(d) the left and decrease the real interest rate.

Answer: B

Question 10. A temporary decrease in government purchases would cause
(a) a rightward shift in the saving curve and a leftward shift in the investment curve.
(b) a rightward shift in the saving curve and a rightward shift in the investment curve.
(c) a rightward shift in the saving curve, but no shift in the investment curve.
(d) no shift in the saving curve, but a leftward shift in the investment curve.

Answer: C

Problem Solving Questions

Question 11. Capital Mobility - United States. The U.S. dollar has maintained or increased its value over the past 20 years despite running a gradually increasing current account deficit. Why has this phenomenon occurred?

The U.S. dollar has maintained or increased its value over the past 20 years despite running a gradually increasing current account deficit because the current account deficit has been more than offset by an inflow of dollars on capital and financial accounts.

Question 12. Capital Mobility - Brazil. Brazil has experienced periodic depreciation of its currency over the past 20 years despite occasionally running a current account surplus. Why has this phenomenon occurred?

Brazil has experienced periodic depreciation of its currency because of speculative flights of capital out of Brazil in response to political and/or economic shocks, including periods of hyperinflation.

Question 13. Classifying Transactions. Classify the following as a transaction reported in a sub-component of the current account or the capital and financial accounts of the two countries involved:

(a) A U.S. food chain imports wine from Chile.

Debit to U.S. goods part of current account, credit to Chilean goods part of current account.

(b) A U.S. resident purchases a euro-denominated bond from a German company.

Debit to U.S. portfolio part of financial account; credit to German portfolio of financial account.

(c) Singaporean parents pay for their daughter to study at a U.S. university.

Credit to U.S. current transfers in current account; debit to Singapore current transfers in current account.

(d) A U.S. university gives a tuition grant to a foreign student from Singapore.

If the student is already in the United States, no entry will appear in the balance of payments because payment is between U.S. residents. (A student already in the U.S. becomes a resident for balance of payments purposes.)

(e) A British Company imports Spanish oranges, paying with eurodollars on deposit in London.
A debit to the goods part of Britains current account; a credit to the goods part of Spains current account.