

Economics 252 – Financial Markets

Spring 2011

Lecture 3: Technology and Invention in Finance

January 19, 2011

Multiple Choice Questions

Question 3.1

What does the Central Limit Theorem state about appropriately scaled averages of independent and identically distributed random variables with finite variance?

- (a) The average has infinite variance.
- (b) The average converges to a normal distribution.
- (c) The distribution of the averages is the same as the distribution of the random variables in it.
- (d) The expected value of the average equals 7.

Question 3.2

What are the contractual specifications for the protection seller of a credit default swap?

- (a) The protection buyer pays the protection seller at regular time intervals, until a credit event occurs, in which case the protection seller pays the protection buyer compensation for the credit event.
- (b) If a credit event occurs, the protection seller is obliged to exchange contractually specified assets for S&P 500 index funds.
- (c) The protection seller pays the protection buyer at regular time intervals, until a credit event occurs, in which case the protection buyer pays the protection seller compensation for the credit event.
- (d) If the underlying of the credit default swap is a specific corporation's stock, only this corporation can act as a protection seller.

Question 3.3

Which legislative framework gave the state of New York a competitive advantage over the state of Massachusetts around 1811?

- (a) New York introduced the concept of limited liability, but Massachusetts decided that shareholders are fully liable for the companies that they own shares in.
- (b) New York simplified the process of creating corporations, whereas Massachusetts dispossessed all corporations in the state that were created by an act of Congress.
- (c) Both New York and Massachusetts introduced limited liability, but New York's version of the law was easier to understand and implement.
- (d) The creation of a corporation in each state was legislated to require the state senate's approval, but the Massachusetts senate refused to give out any approvals.

Question 3.4

Which country introduced the *Unidad de Fomento*, and what was its purpose?

- (a) Chile introduced the Unidad de Fomento to replace the peso as the official currency in the aftermath of a hyperinflation.
- (b) Chile introduced the Unidad de Fomento, and it is a unit of account that is indexed to inflation to counteract the impact of (hyper-)inflation.
- (c) Argentina introduced the Unidad de Fomento, and it corresponds to varying amounts of the Argentine peso in order to provide inflation protection.
- (d) Spain introduced the Unidad de Fomento as a prerequisite to introduce the euro as the official currency in 2002.

Question 3.5

Which of the following are part of U.S. social insurance, that is government-provided tools that contribute to the management of big, and important risks?
(More than one answer may apply.)

- (a) Progressive income taxes.
- (b) The Securities and Exchange Commission.
- (c) Welfare systems.
- (d) Free public education.

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Correct Answers

3.1: (b)

3.2: (a)

3.3: (a)

3.4: (b)

3.5: (a), (c), and (d)