Suppose the total demand and supply of loanable funds (in billions) are as follows:

|  |  |  |  |
| --- | --- | --- | --- |
| **Quantity demanded of loanable funds** | **Interest rate (percent)** | **Quantity supplied of loanable funds** | **Surplus (+)**  **or**  **shortage (–)** |
| 85 | 4 | 72 | \_\_\_\_\_ |
| 80 | 6 | 73 | \_\_\_\_\_ |
| 75 | 8 | 75 | \_\_\_\_\_ |
| 70 | 10 | 77 | \_\_\_\_\_ |
| 65 | 12 | 79 | \_\_\_\_\_ |
| 60 | 14 | 81 | \_\_\_\_\_ |

(a) What will be the market or equilibrium interest rate? What is the equilibrium quantity of loanable funds? Complete the surplus-shortage column.

(b) Why will 4% *not* be the equilibrium interest rate in this market? Why *not* 14%?

(c) Now suppose that the government establishes a usury loan that sets the interest rate at 6%. Explain the economic effects of this usury law.

Briefly explain the loanable funds theory of interest rate determination. How would the following situations affect the equilibrium interest rate in the loanable funds market?

(a) The states agree to abolish sales taxes.

(b) The government reduces the budget deficit.

(c) Technological improvements are made to increase expected rates of return.