Chapter 13
Money and Banking

■ Multiple Choice Questions

Choose the one alternative that best completes the statement or answers the question.

1. The most important function of money is
   (a) as a store of value.
   (b) as a unit of value.
   (c) as a speculative value.
   (d) as a medium of exchange.
   (e) All of the above.
   Answer: D

2. Asset “liquidity” means
   (a) the ease with which you can sell the asset.
   (b) the ease with which you can trade the asset.
   (c) the ease with which you can convert the asset to money.
   (d) the ease with which you can convert the asset to money without risking the value.
   (e) All of the above.
   Answer: D

3. All of the following are part of the M1 definition of money except
   (a) savings accounts.
   (b) travelers’ checks.
   (c) demand deposits.
   (d) currency and coin.
   (e) All of the above are part of M1.
   Answer: A

4. Financial intermediaries include all of the following except
   (a) savings institutions.
   (b) commercial banks.
   (c) finance companies.
   (d) investment banks.
   (e) All of the above are financial intermediaries.
   Answer: E
5. The asset side of a commercial bank’s balance sheet includes all of the following except
   (a) reserves.
   (b) demand deposits.
   (c) consumer loans.
   (d) securities.
   (e) All of the above are included on the asset side of the balance sheet.
   Answer: B

6. The liability side of a commercial bank’s balance sheet includes all of the following except
   (a) reserves.
   (b) demand deposits.
   (c) other borrowings.
   (d) net worth.
   (e) All of the above are included on the liability side of the balance sheet.
   Answer: A

7. If the Federal Reserve System wishes to decrease the money supply, they will
   (a) sell government securities.
   (b) buy government securities.
   (c) increase the discount rate.
   (d) increase the reserve requirement.
   (e) use moral suasion.
   Answer: A

8. Because money serves as a medium of exchange, it eliminates
   (a) the need to write checks.
   (b) the need for specialization.
   (c) the use of commodities as money.
   (d) the need for work.
   (e) the need for a double coincidence of wants.
   Answer: E

9. Which of the following correctly completes this statement? The money supply is
   (a) the sum of all money incomes.
   (b) the cash in banks plus checks written.
   (c) the sum of currency, bank deposits, and coin held by the public and banking industry.
   (d) the sum of currency and deposits held by the public and by the banking industry.
   (e) the sum of currency, deposits and coin held by the public.
   Answer: C

10. One difficulty with using commodity monies is
    (a) that money is then not a stock variable.
    (b) that people may eat the money.
    (c) Gresham’s law.
    (d) that gold and silver may be used as jewelry.
    (e) the commodity price of money often exceeds its value as money.
    Answer: C
11. The technical definition of M2 includes
   (a) M1.
   (b) money-market mutual funds.
   (c) small time deposits.
   (d) currency in circulation.
   (e) All of the above.
   Answer: E

12. The most important motive for holding money is
   (a) the precautionary motive.
   (b) the speculative motive.
   (c) the transactions motive.
   (d) that money is the most liquid of all assets.
   (e) All of the above are important motives.
   Answer: C

13. According to the quantity theory of money, if the supply of money is increased more than demand is increased,
   (a) the price level should fall.
   (b) the price level should rise.
   (c) the price level may go up or down.
   (d) the value of money should rise.
   (e) the value of money will be unchanged.
   Answer: B

14. Money’s function as a medium of exchange means that
   (a) money is a common denominator for expressing the value of goods and services.
   (b) money can be used to store wealth.
   (c) money serves as an acceptable means of payment.
   (d) money is a standard of deferred payment on exchange contracts extending into the future.
   (e) All of the above.
   Answer: C

15. Which of the following has been used as money?
   (a) Fish hooks.
   (b) Tobacco.
   (c) Bird feathers.
   (d) Silk.
   (e) All of the above.
   Answer: E
16. Money serves its most important function as
   (a) a store of value.
   (b) a unit of value.
   (c) a social ladder.
   (d) a standard of deferred payment.
   (e) a medium of exchange.
   Answer: E

17. According to the classical quantity theory, in the short run, a 10 percent increase in the money supply
   (a) increases the price level by 10 percent.
   (b) increases real GDP by 10 percent.
   (c) reduces the price level by 10 percent.
   (d) may not increase the price level by 10 percent if real GDP is constant.
   (e) does not affect the price level.
   Answer: A

18. The major difference between M1 and M2 is that
   (a) M1 is a stock variable while M2 is a flow variable.
   (b) M2 is a stock variable while M1 is a flow variable.
   (c) small time deposits are included in M2.
   (d) traveler’s checks are part of M1.
   (e) M1 is not included in M2.
   Answer: C

19. The most important motive for holding money balances is
   (a) the precautionary motive.
   (b) the speculative motive.
   (c) the altruistic motive.
   (d) the transactions motive.
   (e) All of the above.
   Answer: D

20. Money can serve as a store of value, just as other assets, such as paintings, real estate, or stocks. An increase in the price level will
   (a) increase the value of all types of assets, including money.
   (b) decrease the value of money.
   (c) increase the value of money when money demand is increasing.
   (d) increase the value of money.
   (e) None of the above is correct, the price level does not affect the value of money.
   Answer: B
21. As a commodity (e.g., the use of gold for dental fillings or jewelry), the value of commodity money will be
   (a) equal to its value as money.
   (b) less than its value as money.
   (c) unrelated to its value as money.
   (d) greater than its value as money.
   (e) greater than or equal to its value as money.
   Answer: E

22. Barter is an inefficient means of exchange because
   (a) barter transactions require a double coincidence of wants.
   (b) velocity is constantly changing.
   (c) demand will not necessarily equal supply.
   (d) in a barter transaction only one party needs to want what the other party has to sell.
   (e) barter occurs in relatively primitive economies.
   Answer: A

23. Which of the following is correct? Money is
   (a) a medium of exchange.
   (b) a store of value.
   (c) a unit of account.
   (d) a standard of deferred payment.
   (e) All of the above.
   Answer: E

24. The technical definition of M1
   (a) includes money-market mutual funds.
   (b) includes small time deposits.
   (c) includes checkable deposits like NOW accounts.
   (d) includes money-market mutual funds.
   (e) includes savings and small time deposits.
   Answer: C

25. The distinguishing characteristic of commodity money is that
   (a) its value as a good equals its value as money.
   (b) its value as a good is greater than its value as money.
   (c) its value as a good is less than its value as money.
   (d) its value is always equal to the value of gold.
   (e) it can be used in any economic system.
   Answer: A
26. The demand for money will rise if
   (a) real GDP falls, ceteris paribus.
   (b) the price level rises, ceteris paribus.
   (c) interest rates rise.
   (d) exports rise, ceteris paribus.
   (e) All of the above.
   Answer: B

27. The demand curve for money is
   (a) determined by the amount of currency and demand deposits available to the public.
   (b) infinite, since the public would demand all the money printed by the government.
   (c) determined by the real rate of interest.
   (d) also referred to as the liquidity preference curve.
   (e) a function of the type of money used by a country’s citizens.
   Answer: D

28. Which of the following is NOT included in the definition of M1 but is included in the definition of M2?
   (a) Travelers’ checks.
   (b) Currency.
   (c) ATS (automatic transfer services) accounts.
   (d) Money-market mutual fund shares.
   (e) All of the above are a part of M1.
   Answer: D

29. The basic difference between M1 and other definitions of the money supply, such as M2, is that
   (a) additional “money” included in M2 is less liquid than “money” included only in M1.
   (b) the distinction(s) is (are) somewhat arbitrary—the Fed is unsure how to evaluate money substitutes.
   (c) M1 includes currency only.
   (d) the Fed’s monetary activities have a direct effect on M1 and an indirect effect on other measures of the money supply.
   (e) All of the above are crucial differences.
   Answer: A

30. The money supply, as defined by M1, typically includes
   (a) time deposits and currency.
   (b) coin, currency, and demand deposits.
   (c) coin, currency, and liquid assets.
   (d) coin and currency only.
   (e) stocks, bonds and certificates of deposit.
   Answer: B
31. Which of the following would increase the demand for money, other factors constant?
   (a) A reduction in the nominal interest rate.
   (b) A decrease in real GDP.
   (c) An increase in the supply of money substitutes.
   (d) An increase in the price level.
   (e) An decrease in the natural rate of unemployment.
   Answer: D

32. Suppose an increase in the supply of money occurs, while the demand for money is constant. According to the quantity theory of money, the price level will
   (a) stay the same because of an offsetting decrease in the demand for money.
   (b) rise because as people try to spend excess money balances, prices are driven up.
   (c) fall because real GDP will rise as interest rates fall.
   (d) rise because of a decrease in the demand for money.
   (e) fall because as people try to spend excess money balances, prices are driven down.
   Answer: B

33. The quantity theory of money predicts that an increase in the supply of money will increase the price level. The mechanism restoring equilibrium in the money market is
   (a) an increase in savings from personal income.
   (b) a rising price level which increases the demand for money.
   (c) a shift to money substitutes by individuals and corporations with large money balances.
   (d) a short-run decrease in real GDP, which decreases the demand for money.
   (e) a long-run decrease in real GDP, which decreases the demand for money.
   Answer: B

34. The key idea of the quantity theory of money is
   (a) the nominal rate of interest determines the supply of money.
   (b) the value of money depends on the quality of the materials contained in a country’s money.
   (c) that there are numerous but somewhat less liquid substitutes for money.
   (d) the velocity of circulation determines real GDP.
   (e) the value of money depends on its quantity.
   Answer: E

35. Which of the following is correct? The demand for money
   (a) increases as the price level increases.
   (b) decreases as the price level increases.
   (c) depends on the supply of money.
   (d) is why checkable deposits are called demand deposits.
   (e) depends on the form of money available.
   Answer: A
36. The largest component of M1 is
   (a) currency.
   (b) demand deposits.
   (c) small time deposits.
   (d) the transactions demand for money.
   (e) the speculative demand for money.
   Answer: B

37. Suppose that the face value of a U.S. Treasury bill is $1,000. At last week’s T-bill auction, the bond sold for $950 but at this week’s T-bill auction, the price was $975. Which of the following is correct? Interest rates
   (a) have fallen.
   (b) have stayed about the same if inflation is roughly the same.
   (c) have risen.
   (d) are unaffected by bond prices.
   (e) on T-bills only will rise.
   Answer: A

38. Which of the following is correct? Experience has shown that
   (a) only government can define money.
   (b) many things can serve as money.
   (c) money must be based on silver or gold.
   (d) money is seldom used as a store of value.
   (e) All of the above.
   Answer: B

39. Which of the following is correct? Demand deposits are
   (a) not part of the money supply.
   (b) part of the money supply.
   (c) small in volume relative to currency in circulation.
   (d) quite different from checking accounts.
   (e) equal to M1.
   Answer: B

40. Interest rates rise when bond prices fall because
   (a) the money supply goes up.
   (b) the Fed increases interest rates when bond prices fall.
   (c) bonds promise fixed dollar payments in the future.
   (d) higher interest rates lower the quantity of money demanded.
   (e) investors choose stocks over bonds.
   Answer: C
41. If the money supply increases, holding everything else constant,
   (a) interest rates will rise.
   (b) nothing will happen to the interest rate.
   (c) interest rates will fall.
   (d) the liquidity-preference curve will shift to the left.
   (e) the price level will fall.
   Answer: C

42. If everything is held constant, interest rates should increase if
   (a) the demand for money curve shifts to the left.
   (b) the supply of money increases.
   (c) the Fed injects reserves into the economy.
   (d) the demand for money curve shifts to the right.
   (e) None of the above will increase interest rates.
   Answer: A

43. The intersection of the liquidity-preference curve with the supply of money curve
   (a) causes inflation.
   (b) determines the price level.
   (c) is very difficult.
   (d) determines the nominal interest rate.
   (e) determines the real level of GDP.
   Answer: D

44. When macroeconomists say that the velocity of circulation is equal to 5 in 1996, what they mean is
   that
   (a) consumers held about five dollars in wealth for each dollar they spent in 1996.
   (b) each dollar of money in the economy purchased about five dollars of final goods and services in 1996.
   (c) for each additional dollar of money injected into the economy, the price level rose about 5 percent in 1996.
   (d) real output of final goods and services rose by about five dollars for each additional dollar of money consumers saved.
   (e) None of the above correctly explains what macroeconomists mean.
   Answer: B

45. The unintended consequence of bank deregulation was
   (a) a demand by consumers for information about the relative riskiness of different banks.
   (b) a substantial increase in the rate of bank failures in the late 1980s.
   (c) the bankruptcy of the Federal Deposit Insurance Corporation.
   (d) a gradual decline in the money supply that ultimately precipitated a recession in 1991.
   (e) a tripling of rates for deposit insurance.
   Answer: B
46. Which of the following correctly completes this statement? A bank’s balance sheet shows
   (a) that the bank’s assets minus its liabilities equal its net worth.
   (b) its losses for the year.
   (c) that the bank’s liabilities minus its net worth equals its assets.
   (d) its profits for the year.
   (e) its current market value.
   Answer: A

47. Which of the following is correct? Commercial bank reserves are
   (a) cash in the vault.
   (b) bank deposits at the Fed.
   (c) a fraction of deposit liabilities.
   (d) required by the Fed.
   (e) All of the above are reserves.
   Answer: E

48. The Federal Reserve system does NOT
   (a) consist of 12 regional Federal Reserve banks.
   (b) control the U.S. money supply.
   (c) approve commercial bank loans.
   (d) lend money to commercial banks.
   (e) clear checks.
   Answer: C

49. Assume that at Bank A excess reserves are $0; cash leakages are $0; reserve requirements are 20 percent. If the Fed buys $1,000 in services from Jane Doe, Jane Doe’s checking account at Bank A changes by
   (a) +$200.
   (b) +$1,000.
   (c) −$1,000.
   (d) −$200.
   (e) $0.
   Answer: B

50. Assume that at Bank A excess reserves are $0; cash leakages are $0; reserve requirements are 20 percent. If the Fed buys $1,000 in services from Jane Doe, her bank’s loans or investments could change by
   (a) +$800.
   (b) +$200.
   (c) −$200.
   (d) +$1,000.
   (e) −$800.
   Answer: A
51. Assume that at Bank A excess reserves are $0; cash leakages are $0; reserve requirements are 20 percent. When the Fed buys $1,000 in services from Jane Doe, the initial change in the money supply is
(a) $0.
(b) −$1,000.
(c) +$800.
(d) +$1,000.
(e) +$200.
Answer: D

52. Assume that at Bank A excess reserves are $0; cash leakages are $0; reserve requirements are 20 percent. The Fed’s purchase of $1,000 in services from Jane Doe initiates a multiple-deposit expansion. After a multiple-deposit expansion, the Fed’s purchase of services has changed the money supply by
(a) +$1000.
(b) +$5,000.
(c) −$5,000.
(d) +$2,000.
(e) +$4,000.
Answer: B

53. Which of the following is an example of a financial intermediary?
(a) an insurance company
(b) a stock market mutual fund
(c) a credit union
(d) a commercial bank
(e) All of the above.
Answer: E

54. Which of the following is correct? Commercial banks
(a) are the only financial intermediary providing checking accounts.
(b) are chartered by state agencies or the U.S. Treasury.
(c) are less important as financial intermediaries than thrift institutions.
(d) are no longer the most important financial intermediary.
(e) deal only with businesses.
Answer: B

55. The main source of profits to commercial banks is
(a) the service charge on bank accounts.
(b) the interest earned on their loans.
(c) the proceeds from home and car foreclosures.
(d) the interest earned on the securities they own.
(e) All of the above.
Answer: B
56. If there were no reserve requirements on banks
   (a) banks would still hold reserves.
   (b) most banks would not hold any reserves.
   (c) banks could not be controlled.
   (d) the banking system would eventually collapse.
   (e) None of the above will happen if there were no reserve requirements.
   Answer: A

57. The Board of Governors of the Federal Reserve System consists of
   (a) 7 members appointed by Congress and 7 appointed by the President.
   (b) 5 members appointed by the President and 2 elected members.
   (c) 12 members appointed by Congress.
   (d) 7 members appointed by the President.
   (e) the presidents of each Federal Reserve Bank.
   Answer: D

58. Prior to bank deregulation in the early 1980s, the laws regulating banking activities included
   (a) minimum capital requirements.
   (b) maximum interest rates that could be paid on certain types of accounts.
   (c) restricting commercial banks from selling corporate securities.
   (d) deposit insurance requirements.
   (e) All of the above.
   Answer: E

59. When a bank loans a person $2,000 (from excess reserves) to buy a new car, the money supply at
   that moment
   (a) falls.
   (b) rises by exactly $2,000.
   (c) rises by a fraction of the $2,000.
   (d) rises by a multiple of the $2,000.
   (e) is unchanged.
   Answer: B

60. The lower is the required-reserve ratio
   (a) the smaller must be the money supply.
   (b) the smaller is the multiple expansion of deposits from new reserves.
   (c) the larger is the multiple expansion of deposits from new reserves.
   (d) the lower is the fraction of deposits that can be loaned out.
   (e) the greater is the amount of vault cash or deposits at the Fed held by the commercial banking
       system.
   Answer: C
61. Assuming banks do not wish to hold excess reserves and that there are no cash leakages, if the required-reserve ratio against demand deposits is 10 percent, the deposit multiplier is equal to _____.
   (a) 10
   (b) 5
   (c) 20
   (d) 0
   (e) 8
   Answer: A

62. From 1929 to 1933, a substantial decline in the nation’s money supply occurred. One reason for this decline in the money supply was
   (a) the lack of a central bank in the United States.
   (b) the small interest rate differential between deposits and loans.
   (c) an increase in (excess) reserves held by banks.
   (d) a miscalculation by the monetary authorities about what was happening to the money supply.
   (e) the absence of strong laws regulating bank activities.
   Answer: C

63. The reserves of a commercial bank
   (a) consist of vault cash and deposits at the Federal Reserve.
   (b) are the funds the bank can use to satisfy the cash demands of its customers.
   (c) are a small fraction of the bank’s demand and time deposits.
   (d) can be used to meet the reserve requirements imposed by the Federal Reserve System.
   (e) All of the above.
   Answer: E

64. The interest-rate spread in commercial banking is the spread between
   (a) the discount rate and the prime interest rate.
   (b) rates earned on NOW accounts and regular checking accounts.
   (c) interest rates paid by commercial banks and those paid by savings and loans.
   (d) the interest rates banks charge different customers.
   (e) the interest rate at which banks borrow and the interest rate at which banks lend.
   Answer: E

65. Which of the following correctly defines the components of the monetary base?
   (a) Currency in circulation and checkable deposits.
   (b) M1 plus M2.
   (c) Government bonds and bank loans.
   (d) Reserves at the Fed, vault cash and currency in circulation.
   (e) None of the above.
   Answer: D
66. Which of the following is correct? Central banks
   (a) are located in the central part of the country.
   (b) are necessary to economic development.
   (c) do not usually act as lenders of last resort to private banks.
   (d) have the control of the money supply as a primary function.
   (e) are always required to do as the President/Leader of the country asks.
   Answer: D

67. The reason a multiple expansion of deposits can occur is because
   (a) banks typically hold some excess reserves.
   (b) what one bank can do the whole system cannot do.
   (c) one bank’s excess reserves are loaned out and end up as excess reserves in other banks.
   (d) people convert their demand deposits to cash.
   (e) All of the above.
   Answer: C

68. Commercial banks are able to create money by
   (a) printing Federal Reserve Notes.
   (b) making loans.
   (c) making customers pay back their loans.
   (d) exchanging their reserves at the Fed for vault cash.
   (e) All of the above.
   Answer: B

69. If banks have reserve requirements of 20 percent of their demand deposits, $100 million in excess reserves allows the banking system to create at most
   (a) $100 million in new money.
   (b) $20 million in new money.
   (c) $500 million in new money.
   (d) $80 million in new money.
   (e) $60 million in new money.
   Answer: C

70. Which of the following correctly completes this statement? Required reserves for a commercial bank
   (a) are the reserves needed to back loans made by the bank.
   (b) are the reserves legally required to be held in the bank’s vault.
   (c) are the money used by the bank tellers.
   (d) consist only of deposits at the Fed.
   (e) are the reserves a bank is legally required to hold to back its deposits.
   Answer: E
71. If the reserve requirements are 10 percent, an extra dollar of reserves will increase banking-system deposits by as much as
   (a) $0.10.
   (b) $10.
   (c) $5.
   (d) $1.
   (e) $0.90.
   Answer: B

72. Banks create money when
   (a) there is a central bank.
   (b) demand deposits are used as money.
   (c) they make a deposit at the Federal Reserve.
   (d) the type of money used by the nation is fiat money.
   (e) there is a legal requirement specifying the fraction of reserves that banks must hold.
   Answer: B

73. The money supply fell dramatically from 1929 to 1933, from $26.4 billion to $19 billion. One explanation for this large decline in the money supply is
   (a) the lack of a central bank.
   (b) a large increase in bank reserves stimulated by monetary authorities.
   (c) the large number of small banks in existence in 1929.
   (d) cash withdrawals by the public from the banking system.
   (e) the small number of creditworthy borrowers had as customers.
   Answer: D

74. The major contributor to the increase in bank failure rates after deregulation is
   (a) fraud by bankers.
   (b) inadequate regulatory review of bank loans.
   (c) federal deposit insurance.
   (d) inadequate capital requirement for banks.
   (e) All of the above.
   Answer: C

75. One problem with federal deposit insurance during the 1980s was that
   (a) bankers had minimal incentives to loan depositors’ money prudently.
   (b) only deposits up to $100,000 were insured.
   (c) real estate loans were especially risky business during the 1980s.
   (d) only deposits at savings and loans were insured.
   (e) inflation eroded the value of insurance to the insurance fund.
   Answer: A
76. Which of the following is correct? The Federal Reserve System
   (a) is America’s central bank.
   (b) imposes reserve requirements on all depository institutions.
   (c) was established early in this century.
   (d) regulates the financial markets.
   (e) All of the above.
Answer: E

77. Which of the following is correct? The monetary base consists of
   (a) the money supply.
   (b) vault cash, currency in circulation, and bank deposits at the Fed.
   (c) demand deposits and vault cash.
   (d) government securities held by the Fed.
   (e) bank deposits at the Fed.
Answer: B

78. The function of the Federal Deposit Insurance Corporation (FDIC) is
   (a) to insure bank loans.
   (b) to insure the nation’s money supply.
   (c) to insure bank deposits up to $100,000.
   (d) to guarantee that no depositor will ever lose any money from a bank failure.
   (e) All of the above.
Answer: C

79. Which of the following is correct? A single bank out of many
   (a) can create an amount of money equal to a multiple of its excess reserves.
   (b) cannot create money even though all banks can.
   (c) can create an amount of money equal to its excess reserves.
   (d) can print fiat currency whenever it buys something.
   (e) can create an amount of money greater than its excess reserves.
Answer: C

80. The reason a system of many banks can create a multiple expansion of bank deposits is that
   (a) each bank can create a multiple expansion of its bank deposits.
   (b) people do not hold all their money in checking deposits.
   (c) the monetary base equals the supply of money.
   (d) reserves need only be a fraction of demand deposits.
   (e) All of the above.
Answer: D

81. Banks create money whenever they
   (a) accept a deposit.
   (b) disburse funds in payment of a check.
   (c) receive monthly payments on their loans.
   (d) receive interest on existing loans.
   (e) lend excess reserves to a borrower.
Answer: E
82. If the required-reserve ratio is 20 percent and the Fed injects $1 billion in new reserves into the banking system by purchasing a supercomputer, the money supply can increase by no more than
(a) + $5 billion.
(b) + $0.20 billion.
(c) + $1 billion.
(d) + $2 billion.
(e) + $.80 billion.
Answer: A

83. The free market plan for banking reform would
(a) eliminate the Federal Reserve.
(b) allow depositors a choice between insured and uninsured accounts.
(c) eliminate deposit insurance.
(d) restore restrictions on the types of loans that thrift institutions could make.
(e) regulate real estate lending by bankers.
Answer: C

84. By multiple-deposit expansion, economists mean
(a) the Fed’s ability to control the money supply.
(b) cash leakage into excess reserves held by commercial banks.
(c) an individual commercial bank can lend out some multiple of its excess reserves.
(d) financial intermediation.
(e) an expansion of the money supply that is greater than the associated reserve increase.
Answer: E

85. The monetary base does NOT include
(a) checkable deposits.
(b) reserves with the Fed.
(c) vault cash held by banks.
(d) currency in circulation.
(e) currency at the banks.
Answer: A