Chapter 11 Money and Banking

1. The required reserve ratio is
   a. set by Congress, and refers to the percentage of a bank’s total deposits that must be held in reserves.
   b. set by the Fed, and refers to the percentage of a bank’s total deposits that must be held as reserves.
   c. the percentage of a bank’s total reserves that must take the form of vault cash.
   d. the percentage of a bank’s total reserves that must be held at the Federal Reserve district bank.

   ANS:
   a. Incorrect. The Fed, not Congress, sets the required reserve ratio.
   b. Correct.
   c. Incorrect. The required reserve ratio is set by the Fed and refers to the percentage of a bank’s total deposits that must be held as reserves.
   d. Incorrect. The required reserve ratio is set by the Fed and refers to the percentage of a bank’s total deposits that must be held as reserves.

2. Suppose that the ABC bank has reserves of $27,000 and checkable deposits of $110,000. If the required reserve ratio is 20 percent, the ABC bank has excess reserves of
   a. $7,000.
   b. $5,000.
   c. $21,600.
   d. $3,000.

   ANS:
   a. Incorrect. Excess reserves are $5,000 because required reserves are 20 percent of $110,000.
   b. Correct.
   c. Incorrect. Excess reserves are $5,000 because required reserves are found by taking 20 percent of $110,000
   d. Incorrect. Excess reserves are $5,000 because required reserves are 20 percent of $110,000.

3. Assuming the ABC bank has excess reserves of $5,000, it could prudently expand its loans by a maximum of
   a. $35,000.
   b. $5,000.
   c. $12,000.
   d. $50,000.

   ANS:
   a. Incorrect. A single bank can prudently lend up to its excess reserves which, in this case, are $5,000
b. Correct.
c. Incorrect. A single bank can prudently lend up to its excess reserves, which, in this case, are $5,000.
d. Incorrect. A single bank can prudently lend up to its excess reserves, which, in this case, are $5,000.

4. If the banking system had excess reserves of $5,000, and assuming that the required reserve ratio is 20 percent, the banking system could expand loans (i.e. create checkable deposits) by a maximum of
a. $35,000.
b. $25,000.
c. $48,000.
d. $15,000.

ANS:
a. Incorrect. The answer is $25,000 because the simple deposit multiplier is 5
b. Correct.
c. Incorrect. The answer is $25,000 because the simple deposit multiplier is 5
d. Incorrect. The answer is $25,000 because the simple deposit multiplier is 5

5. Cash leakages from the economy
a. enhance the money expansion process.
b. slow down the money expansion process.
c. occur when people end up spending more than they had intended to spend.
d. none of the above

ANS:
a. Incorrect. A cash leakage results in less money being held in banks, and therefore the banks will not be allowed to loan out as much money as they would have without the cash leakage.
b. Correct.
c. Incorrect. Cash leakage occurs when people choose to hold money in the form of cash rather than depositing it into a checking account.
d. Incorrect. The correct answer is B

6. A bank’s reserves are computed as the sum of
a. its vault cash and the bank’s deposits at the Fed.
b. the sum of its vault cash and the market value of its holdings of U.S. government securities.
c. the sum of the bank’s deposits at the Fed and its loan portfolio.
d. none of the above

ANS:
a. Correct.
b. Incorrect. Government securities are highly liquid assets, but do not count in the computation of reserves.
c. Incorrect. Reserves are the sum of vault cash and bank deposits at the Fed.
d. Incorrect. Answer A is correct.

7. In what way is a barter system inefficient relative to a money economy?
a. In barter transactions the gains from trade for buyers come at the expense of an equivalent loss from trade for sellers.
b. Buyers and sellers frequently do not share a double coincidence of wants which results in relatively higher transaction costs.
c. It is not possible to determine the quality of the goods being exchanged in a money system.
d. There is unanticipated inflation in the money system, which increases a buyer's purchasing power.

ANS:
a. Incorrect. Barter can be inefficient because frequently buyers and sellers do not share a double coincidence of wants.
b. Correct.
c. Incorrect. Barter can be inefficient because frequently buyers and sellers do not share a double coincidence of wants.
d. Incorrect. Barter can be inefficient because frequently buyers and sellers do not share a double coincidence of wants.

8. What is the unit of account function of money?
a. To provide a common measurement of the relative value of different goods and services.
b. The ability of money to hold value over time.
c. The materials used to manufacture money are of medium grade or poor quality, so that people will not hoard money for its value as a commodity.
d. Money is generally acceptable in exchange for goods and services.

ANS:
a. Correct.
b. Incorrect. The ability of money to hold value over time is its “store of value” function.
c. Incorrect. The unit of account function provides a common measurement of the relative value of different goods and services.
d. Incorrect. The unit of account function provides a common measurement of the relative value of different goods and services.

9. What is the store of value function of money?
a. To provide a common measurement of the relative value of different goods and services.
b. The ability of money to hold value over time.
c. The materials used to manufacture money are of medium grade or quality, so that people will not hoard money for its commodity value.
d. Money is generally acceptable in exchange for goods and services.
ANS:

a. Incorrect. Providing common measurement of the relative value of different goods and services is the *unit of account* function of money.
b. Correct.
c. Incorrect. The ability of money to hold value over time is its *store of value* function.
d. Incorrect. The ability of money to hold value over time is its *store of value* function.

10. In the United States, what gives paper money its value?

a. Paper money is valuable because of its general acceptability.
b. Paper money is valuable because it is backed by the value of the gold stored in Fort Knox.
c. Paper money is valuable in direct proportion to its commodity value, and thus can be converted to some other valuable use if it no longer is considered acceptable as money.
d. none of the above

ANS:

a. Correct.
b. Incorrect. Today our paper money is not backed by gold or silver, or any other commodity.
c. Incorrect. Paper money has value because of its general acceptability.
d. Incorrect. Answer A is correct