Economics 2020-010 University of Colorado
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Practice Problems:
Chapter 14 Money, Banking, and the Federal Reserve System

1. Money is:
   A) any asset the government says is money.
   B) any asset that can easily be used to purchase goods and services.
   C) any asset that has a positive value.
   D) all of the above.

2. When we use money to buy groceries, money is playing the role of:
   A) medium of exchange.
   B) reserve of wealth.
   C) unit of account.
   D) store of value.

3. When we keep part of our wealth in a savings account, money is playing the role of:
   A) medium of exchange.
   B) unit of account.
   C) barter.
   D) store of value.

4. When we put a price on a meal, money is playing the role of:
   A) medium of exchange.
   B) unit of account.
   C) barter token.
   D) store of value.

5. When countries replaced gold and silver coins with paper money exchangeable for certain amounts of precious metals, the monetary system evolved from:
   A) using commodity money to using fiat money.
   B) using commodity-backed money to using fiat money.
   C) using commodity money to using commodity-backed money.
   D) using fiat money to using commodity-backed money.

6. Commodity-backed money is:
   A) a medium of exchange with some intrinsic value.
   B) equivalent to commodity money.
   C) a medium of exchange which has alternative economic uses.
   D) none of the above.

7. Money whose value derives entirely from its official status as a means of exchange is known as
   A) commodity money.
   B) commodity-backed money.
   C) fiat money.
   D) bank reserves.

8. The monetary aggregates from most liquid to least liquid are:
   A) $M1$, $M2$ and $M3$.
   B) $M3$, $M2$ and $M1$.
   C) $M2$, $M3$ and $M1$.
   D) $M3$, $M1$ and $M2$.

9. The U.S. dollar is defined as:
   A) fiat money, because it was created by an act of law.
   B) faith money, because we trust the government to defend its value.
   C) commodity-backed money, because it is convertible into gold.
   D) commodity money, because it is widely used to buy commodities.

10. Included in the M2 definition of money is (are)
    A) Currency in circulation
    B) Money market funds
    C) Traveler's checks
    D) Currency in circulation, money market funds, and travelers' checks

11. The primary difference between $M1$ and $M2$ is that:
    A) the dollar amount of $M1$ is much larger than the dollar amount of $M2$.
    B) $M1$ includes checkable deposits, but $M2$ does not.
    C) $M2$ includes checkable deposits, but $M1$ does not.
    D) $M2$ includes savings deposits and time deposits, but $M1$ does not.

12. Which of the following financial assets belongs to $M2$, but not to $M1$?
    A) a savings account
    B) a checkable deposit
    C) currency
    D) travelers' checks

13. If currency in circulation is $100 million, demand deposits are $500, savings deposits are $300 million and travelers' checks are $10 million, then the *M*1 money supply is:
   A) $100 million.
   B) $410 million.
   C) $610 million.
   D) $900 million.

14. Which of the following is a "near-money"?
   A) a traveler's check
   B) a credit card
   C) a debit card
   D) a savings account

15. Banks can lend money because:
   A) they have so much to lend.
   B) they know not everyone wants their deposits back at the same time.
   C) there is a high demand for loans.
   D) they know how much cash they have in their vault.

16. Banks don't lend out all of the funds placed in their hands by depositors because:
   A) it would not be profitable.
   B) they have to satisfy any depositor who wants to withdraw funds.
   C) they need to reduce their liquidity position.
   D) they need to make more money on interest-bearing deposits.

17. The reserve ratio is:
   A) the fraction of its deposits that a bank holds as reserves.
   B) the fraction of its loans that a bank is required to hold.
   C) the fraction of its loans that a bank holds as reserves.
   D) none of the above.

18. The reserve ratio is the:
   A) bank's holdings of gold.
   B) government's holdings of gold at Fort Knox.
   C) fraction of deposits the banks hold in their vaults plus their deposits at the Federal Reserve.
   D) ratio of gold to the paper money in the economy.

19. If a bank has deposits of $100,000, loans of $200,000, cash on hand of $10,000, and $15,000 on deposit at the Federal Reserve, then its reserve ratio is:
    A) 5%.
    B) 10%.
    C) 12.5%.
    D) 25%.

20. A bank run can "break a bank" because:
    A) borrowers default on their loans, and the bank's assets become worthless.
    B) banks can not convert quickly illiquid loans into liquid assets without facing a large financial loss.
    C) depositors' panic spreads to borrowers, who want to take additional loans from the bank.
    D) the bank's reserves kept with the Federal Reserve are in the form of illiquid U.S. Treasury bonds.

21. Among the assets of a bank are:
    A) deposits.
    B) loans.
    C) borrowings.
    D) all of the above.

22. Among the liabilities of banks are:
    A) deposits.
    B) loans.
    C) reserves.
    D) all of the above.

23. Which of the following would be the initial effect of an individual making a $10,000 cash deposit in a bank?
    A) The money supply would rise by $10,000.
    B) The money supply would fall by $10,000.
    C) The money supply would not be affected by the deposit.
    D) The money supply would fall, but by less than the $10,000 deposit.

24. Banks create money when they:
    A) make loans.
    B) take deposits.
    C) hold excess reserves.
    D) pay withdrawals to depositors.

25. Suppose the reserve ratio is 20%. If Sam deposits $500 into his checking account, his bank can increase loans by:
    A) $500.
    B) $2,500.
    C) $100.
    D) $400.

26. Suppose the reserve ratio is 20%. If Holly deposits $1,000 of cash into her checking account and her bank lends $600 to Freda, the money supply:
    A) remains the same.
    B) decreases by $1,000
    C) decreases by $600.
    D) increases by $600

27. The Federal Reserve Bank of the United States is:
    A) a purely private central bank.
    B) a purely public central bank.
    C) is part of the U.S. government.
    D) is not exactly part of the U.S. government, but not really a private institution either.

28. The Fed controls:
    A) the discount rate.
    B) the monetary base.
    C) the reserve ratio
    D) all of the above.

29. All of the following are responsibilities of the Fed EXCEPT:
    A) control the monetary base.
    B) mint bills and coins.
    C) oversee and regulate the banking system.
    D) set the discount rate.

30. The three main monetary policy tools are:
    A) interest rates, taxes, government purchases, and transfers.
    B) currency, near-moneys, and reserve ratio.
    C) deposit insurance, discount rate, and money multiplier.
    D) reserve requirements, the discount rate, and open-market purchases.

31. The discount rate is the interest rate the Fed charges on loans to:
    A) consumers.
    B) the federal government.
    C) state governments.
    D) banks.

32. If the Fed increases the discount rate:
    A) the money supply is likely to decrease.
    B) the money supply is likely to increase.
    C) the money supply is not likely to change.
    D) the federal funds rate must decrease.

33. Federal funds are:
    A) government tax receipts.
    B) loans between banks.
    C) government expenditures.
    D) bank deposits at the Federal Reserve.

34. To _______ the money supply, the Fed could ________.
    A) increase; lower the reserve requirements
    B) decrease; lower the discount rate
    C) increase; raise the federal funds rate
    D) decrease; conduct open-market purchases

35. Open-market operations occur when the Fed:
    A) buys U.S. Treasury bills from the federal government.
    B) buys or sells U.S. Treasury bills.
    C) buys or sells existing U.S. Treasury bills.
    D) does all of the above.

36. If the Fed conducts an open-market purchase:
    A) bank reserves decrease and the money supply decreases.
    B) bank reserves increase and the money supply increases.
    C) bank reserves decrease and the money supply increases.
    D) bank reserves increase and the money supply decreases.

37. If the Fed conducts a $10 million open-market sale and the reserve requirement is 20%, the monetary base will:
    A) increase by $10 million.
    B) increase by $8 million.
    C) decrease by $10 million.
    D) decrease by $50 million.

38. If the Fed conducts a $10 million open-market sale and the reserve requirement is 20%, the maximum change in the money supply is:
    A) an increase of $10 million.
    B) a decrease of $10 million.
    C) a decrease of $8 million.
    D) a decrease of $50 million.

39. When the Fed decreases bank's reserves through an open-market operation:
    A) deposits increase, currency in circulation increases, and the monetary base remains the same.
    B) the monetary base decreases, the money multiplier decreases, and the money supply increases.
    C) loans increase, the federal funds rate rises, and the discount rate rises.
    D) the monetary base decreases, loans decrease, and the money supply decreases.

40. Suppose the Federal Reserve were to engage in open-market operations by buying $100 million of U.S. Treasury bills. Which of the following would be end result of such an action?
    A) The money supply would stay the same.
    B) The money supply would decrease by $100 million.
    C) The money supply would increase by $100 million.
    D) The money supply would increase by more than $100 million.

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Answer Key

1. B
2. A
3. D
4. B
5. C
6. A
7. C
8. A
9. A
10. D
11. D
12. A
13. C
14. D
15. B
16. B
17. A
18. C
19. D
20. B
21. B
22. A
23. C
24. A
25. D
26. D
27. D
28. D
29. B
30. D
31. D
32. A
33. B
34. A
35. C
36. B
37. C
38. D
39. D
40. D