Financial System Financial Regulation and Central Bank Policy 1st edition Cargill Test Bank

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Chapter 2: Basic Definitions and Concepts

Multiple Choice Questions

1. The M1 measure of money is
   a) the most widely accepted measure of money.
   b) is larger than the M0 measure of money because it includes savings and time deposits.
   c) emphasizes the medium of exchange function of money compared to M2.
   d) emphasizes the unit of account function of money compared to M2.
   C

2. Which statement is not correct regarding the unit of account function of money?
   a) It reduces the number of exchange ratios for goods and services one has to keep in mind.
   b) It dramatically increases the usefulness of money.
   c) It allows us to compare the value of dissimilar things.
   d) It is not a necessary function of money.
   D

3. Which statement is not correct regarding the medium of exchange function of money?
   a) It represents command over resources in the market place.
   b) It eliminates the coincidence of wants required in a barter economy.
   c) It is a necessary function of money.
   d) It is a sufficient function of money.
   D

4. Which is incorrect regarding financial assets?
   a) Financial assets represent wealth.
   b) Financial assets are the same as money.
   c) Financial assets generally have higher liquidity than real assets.
   d) Some financial assets are money.
   B

5. Which is incorrect regarding real assets?
   a) Real assets are not money.
   b) Real assets represent wealth.
   c) Real assets have about the same degree of liquidity as financial assets.
   d) Real assets are less liquid than financial assets.
   C

6. In general, financial assets
   a) possess more liquidity than real assets.
   b) possess less liquidity than real assets.
   c) are part of the M2 measure of money.
   d) are part of the M1 measurement of money.
   A

7. In general, real assets
   a) possess less liquidity than financial assets
   b) possess more liquidity than financial assets.
   c) depending on their liquidity are part of the M1 measure of money.
   d) depending on their liquidity are part of the M2 measure of money.
   A

8. Money is best understood as
   a) a unit of account.
   b) a medium of exchange.
   c) a store of wealth.
   d) all three.
   D

9. The entity responsible for measuring the nation's money supply is the
   a) U.S. Treasury.
   b) Federal Reserve System.
   c) Department of Money Measurement.
   d) Federal Deposit Insurance Corporation.
   B

10. The Federal Reserve System publishes two official measure of the money supply:
   a) M1 and M3.
   b) M1 and M2.
   c) M2 and M3.
   d) M0 and M1.
   B

11. M1 includes
   a) currency, savings deposits and money market deposit accounts.
   b) currency, traveler's checks and checking accounts.
   c) small-denomination time deposits and savings accounts.
   d) money market deposit accounts, currency and checking accounts.
   B

12. M2 includes
    a) M1 plus savings deposits, small-denomination time deposits and money market funds.
    b) M1 plus savings deposits, small-denomination time deposits and retail money market funds.
    c) M1 plus savings deposits, time deposits (including large CDs), and retail money market funds.
    d) M1 plus the difference between M2 and M3.
    B

13. Both M1 and M2 include
    a) currency.
    b) money market deposit accounts.
    c) savings deposits.
    d) time deposits.
    A

14. Compared to M1, the M2 measure of money emphasizes to a greater degree the
    a) unit of account function of money.
    b) transactions function of money.
    c) store of wealth function of money.
    d) medium of exchange function of money.
    C

15. Which is correct regard the M1 and M2 measure of the money supply?
    a) Both are officially used by central banks.
    b) M2 is far more widely used by central banks than M1.
    c) M1 and M2 have the same degree of liquidity.
    d) M1 includes traveler's checks, but these are not included in M2.
    B

16. All checking deposits issued by depository institutions are federally insured up to
    a) $250,000 per account.
    b) $270,000 per account.
    c) $150,000 per account.
    d) $175,000 per account.
    A

17. Money market funds are issued by
    a) depository institutions.
    b) securities companies.
    c) the Federal Reserve.
    d) federally insured securities companies.
    B

18. In general, the relationship between the nominal and real value of any economic variable is expressed by the following:
    a) Real Value = Price Level/Nominal Value.
    b) Real Value = Nominal Value * Price Level.
    c) Real Value = Price Level * Real Value.
    d) Real Value = Nominal Value/Price Level.
    D

19. As a result of the upward bias in the CPI,
    a) recipients of social security are overcompensated for inflation.
    b) Cost of Living Adjustments tied to the CPI overcompensate wage earnings for inflation.
    c) tax revenue is lower because the tax brackets are over adjusted for inflation.
    d) all of the above.
    D

20. The Boskin 1.1% Bias refers to the fact that the
    a) CPI overstates inflation by 1.1 percentage points.
    b) CPI understates inflation by 1.1 percentage points.
    c) CPI overstates inflation upward bias by 1.1%.
    d) CPI understates inflation upward bias by 1.1%.
    A

21. The upward bias in the CPI is due to which of the following:
    a) random measurement errors.
    b) substitution effects of changes in the overall level of prices as opposed to changes in relative prices.
    c) quality effects that result in the price index overcompensating for quality improvements.
    d) failure to adequately account for the general improvement in the quality of goods and services.
    D

22. Which of the following is the key element in the concept of an inverted pyramid monetary system?
    a) government regulation.
    b) central bank policy.
    c) fractional reserves.
    d) gold.
    C

23. The inverted monetary or modern monetary system is best described by which of the following?
    a) The system represents a government innovation rather than a market innovation.
    b) The system represents a market innovation rather than a government innovation.
    c) The system was established at the same time the Federal Reserve was established in 1913.
    d) The system does not require a role for government to operate properly.

    B

24. The basic long run implication of the QTM is that there is
    a) an inverse relationship between money and prices.
    b) a positive relationship between money and prices.
    c) an inverse relationship between money and real output.
    d) a positive relationship between money and real output.

    B

25. In terms of the concept of nonneutrality and neutrality of money in the QTM, which statement is correct?
    a) money is neutral is both the short and long run.
    b) money is neutral in the short run but not the long run.
    c) money is nonneutral in both the short and long run.
    d) money is neutral in the long run but nonneutral in the short run.

    D

True/False Questions:

1. The M1 measure of money is the base measure of money and included in all other measures of the money supply such as M2 and M3.
   T

2. The unit of account function of money dramatically reduces the number of exchange ratios one has to keep in mind when shopping at Macy's.
   T

3. The medium of exchange function of money eliminates the coincidence of wants required in a barter economy.
   T

4. The value of money is inversely related to the price of goods and services purchased with money.
   T

5. Money is the most liquid asset in the economy because it is backed by gold.
   F

6. Financial assets are generally less liquid than real assets.
   F

7. Money is less risky than other financial assets.
   T

8. Holding risk and other things constant for financial assets, higher interest rates on financial assets provide incentives to hold less money.
   T

9. Holding risk and other things constant for financial assets, lower interest rates provide incentives to hold less money.
   F

10. Central banks are responsible for measuring the nation's money supply and emphasize the M2 measure over the M1.
    T

11. The Federal Reserve System publishes three official measures of the money supply: M1, M2 and M3.
    F

12. The M1 measure of money emphasizes the medium of exchange function while M2 emphasizes the store of wealth function.
    T

13. M1 consists of currency, traveler's checks, and checking accounts.
    T

14. M2 includes both retail and institutional money market funds.
    F

15. M2 is defined as M1 plus savings deposits, small-denomination time deposits and retail money market funds.
    T

16. Thrifts consists of savings and loan associations (S&Ls), savings banks and credit unions, but are depository institutions like commercial banks.
    T

17. All checking deposits issued by depository institutions are federally insured up to $250,000 per account.
    T

18. The value of any form of money is determined by the power of money to command resources in the market place.

T

19. The Consumer Price Index is biased upward and as a result, increases government spending and reduces tax revenue.
T

20. According to the QTM, the price level depends on the level of the money supply, other things held constant.
T

21. The inverted pyramid monetary system describes both commodity money and modern money like checking accounts.
F

22. According to the QTM, money can influence both prices and output in the long run.
F

23. While there is much variation in the relationship between the growth rate of money and inflation, the relationship becomes more stable and positive in the long run.
T

24. The bias in the CPI suggests that those on social security are being overcompensated for inflation.
T

25. Adjusting the CPI for the bias to obtain a measure of the "real" inflation rate would lower government spending and increase tax revenue.
T