Chapter 16 review

Multiple Choice
Identify the letter of the choice that best completes the statement or answers the question.

____ 1. Why does the Federal Reserve alter monetary policy?
a. to regulate the banking industry
b. to provide services to member banks
c. to enable banks to clear checks
d. to lessen the effect of natural business cycles

____ 2. What is the cost of money?
a. the smoothing out of fluctuations in the market
b. the economy's use of open market operations
c. the price of the interest rate
d. the bank's use of money creation

____ 3. What was one reason the U.S. government started a Federal Reserve system?
a. to keep the banking power of the United States spread out among various districts
b. to make sure that the U.S. banks were obeying laws regarding banking
c. to have a place for banks to deposit their excess deposits
d. to provide consumers with access to funds for business expansion

____ 4. How quickly can an increase in government spending increase the gross domestic product?
a. immediately
b. 3 months
c. 6 months
d. 1 year

____ 5. How could the Federal Reserve encourage banks to lend out more of their reserves?
a. reduce the discount rate
b. raise the required amount of reserve
c. increase the prime rate
d. reduce the money supply

____ 6. How many Federal Reserve Districts are there?
a. 6
b. 9
c. 12
d. 20

____ 7. What does "lender of last resort" mean with respect to the Federal Reserve?
a. It will lend money to a bank in a financial emergency.
b. It makes decisions about who a bank can lend money to.
c. It decides interest rates for interbank loans.
d. It has the power to decide how much money a bank can lend out.

____ 8. What type of policy does the Federal Reserve use to counteract an expansion that is causing high interest rates?
a. fiscal policy
b. tight money policy
c. easy money policy
d. policy lags

____ 9. Why does a bank sometimes hold excess reserves?
a. to be sure they can meet their customers' demands
b. to protect against high prices
c. to make check clearing easier
d. to keep from lending too much money

____ 10. Which of the following is one way the Federal Reserve Bank serves the government?
a. making loans to the government
b. selling government securities
c. minting coins for the government
d. financing state government projects

____ 11. What type of policy does the Fed use to counteract a contraction?
a. fiscal policy
c. easy money policy

b. tight money policy
d. policy lags

____ 12. What is one possible short-term effect of an easy money policy?
a. decreasing inflation
c. a contracting money supply
b. higher interest rates
d. increased investment spending

____ 13. What is the role of the Federal Open Market Committee?
a. It collects information about each Federal Reserve District and reports on economic conditions to the Board of Governors.
b. Composed of seven members appointed by the President, it oversees the Federal Reserve System.
c. It redraws the map of the twelve Federal Reserve Districts every ten years in response to economic changes.
d. It makes key decisions about interest rates and the growth of the United States money supply.

____ 14. If the money multiplier is 4, the required reserve ratio is
a. 2 percent.
c. 25 percent.
b. 20 percent.
d. 50 percent.

____ 15. The Required Reserve Ratio is 10 percent. The money multiplier is
a. .1.
c. .9.
b. 1.
d. 10.

____ 16. As commercial banks keep more excess reserves, money creation
a. increases.
c. remains the same.
b. decreases.
d. could either increase or decrease.

____ 17. The Federal Reserve system consists of ______ Federal Reserve Banks.
a. 8
c. 12
b. 10
d. 14

____ 18. Which of the following instruments is NOT used by the Federal Reserve to change the money supply?
a. the discount rate
c. the federal tax code
b. the required reserve ratio
d. open market operations

____ 19. The most-used instrument for controlling week-to-week changes in the money supply is
a. the required reserve ratio.
c. open market operations.
b. the money multiplier.
d. the discount rate.

____ 20. What effect would an increase in the discount rate have on the money supply?
a. It would cause the money supply to contract.
b. It would increase the money multiplier.
c. It would cause the money supply to expand.
d. It would have no effect on the money supply.

____ 21. Which of these situations is most likely to cause the Fed to introduce a tight money supply?
a. A recession has reduced aggregate demand and increased unemployment.
b. The federal government passes a new budget with a large deficit.
c. The economy is prosperous with relatively low inflation and low unemployment.
d. The economy is expanding quickly and inflation is a concern.

____ 22. How well did the Federal Reserve Banks perform during the Great Depression?
a. The Great Depression took place before the Federal Reserve System was established.
b. Individual governors of the Federal Reserve Banks disagreed over policy and were unable to stop the depression.
c. The Chair of the Board of Governors made bad decisions and directed the twelve Federal Reserve Banks to act in ways that harmed the economy.
d. The Federal Reserve System skillfully guided the United States economy out of the Great Depression.

____ 23. Which of these tools in an example of monetary policy?

a. reducing income taxes
b. changing reserve requirements
c. increasing government spending
d. borrowing money through deficit spending

____ 24. Suppose the required reserve ratio is 20 percent. A $5 million deposit allows commercial banks to create as much as

a. $25 million.
b. $10 million.
c. $5 million.
d. $1 million.

____ 25. What is the relationship between interest rates and demand for money?

a. As interest rates decrease, demand for money increases.
b. As interest rates increase, demand for money increases.
c. Interest rates are determined by demand for money.
d. Interest rates and demand for money are unrelated.

____ 26. Which of these is an example of inside lag in monetary policy?

a. Corporations respond slowly to increases in interest rates by reducing their planned investment for future years.
b. Individual banks ignore a reduction in the required reserve ratio and hold excess reserves.
c. Members of the Board of Governors disagree on the state of the economy and refuse to lower the discount rate until several months after a recession has begun.
d. The federal government debates a new public works program and ultimately chooses not to spend money on new highways and railroads.

Matching

Identifying Key Terms
Match each term with the correct statement below.

a. prime rate
b. required reserve ratio
c. check clearing
d. open market operations
e. net worth
f. easy money policy
g. tight money policy
h. federal funds rate
i. Board of Governors
j. Federal Reserve Districts

____ 27. the fraction of deposits that banks must keep on hand
____ 28. the buying and selling of government securities to alter the supply of money
____ 29. interest rate banks charge each other for loans
____ 30. monetary policy that increases the money supply
____ 31. the process by which banks record whose account gives up money and whose account receives money
____ 32. the seven-member group that oversees the Federal Reserve System
____ 33. total assets minus total liabilities
____ 34. rate of interest banks charge on short-term loans to their best customers

Identifying Key Terms
Match each term with the correct statement below.

a. discount rate
b. money multiplier formula
c. money creation
d. inside lag
e. outside lag
f. Federal Advisory Council (FAC)
g. monetary policy
h. monetarism
i. bank holding company
j. open market operations

_____ 35. the process by which money enters into circulation
_____ 36. delay in implementing monetary policy
_____ 37. the buying and selling of government securities to alter the supply of money
_____ 38. a company that owns more than one bank
_____ 39. the time it takes for monetary policy to have an effect
_____ 40. the actions the Federal Reserve takes to influence the level of real GDP and the rate of inflation in the economy
_____ 41. rate the Federal Reserve charges for emergency loans to banks
_____ 42. the research arm of the Federal Reserve

Short Answer

Reading a Chart

Fiscal and Monetary Policy Tools		
	Fiscal policy tools	**Monetary policy tools**
Expansionary tools	1. increasing government spending 2. cutting taxes	1. open market operations: bond purchases 2. decreasing the discount rate 3. decreasing reserve requirements
Contractionary tools	1. decreasing government spending 2. raising taxes	1. open market operations: bond sales 2. increasing the discount rate 3. increasing reserve requirements

Figure 16.1

43. According to Figure 16.1, what is the difference between fiscal and monetary policy?

44. According to Figure 16.1, what kind of policy brings tax cuts?

45. According to Figure 16.1, who is responsible for using monetary policy tools?

46. According to Figure 16.1, who institutes fiscal policy?

47. According to Figure 16.1, what kind of policy occurs when the Federal Reserve buys bonds?

48. According to Figure 16.1, how does the federal government enact an expansionary policy?

Essay

Critical Thinking

49. **Cause and Effect** How does the Federal Reserve decrease the money supply through open market operations?

50. **Analyzing Information** How does the money multiplier work?

51. **Making Comparisons** What is the difference between an inside lag and an outside lag?

52. **Identifying Central Issues** What are the four factors that affect demand for money?

53. **Cause and Effect** How does the Federal Reserve increase the money supply through open market operations?

54. **Determining Relevance** Why does the Federal Reserve use open market operations much more freely than changing the discount rate or the reserve requirements?

Chapter 16 review
Answer Section

MULTIPLE CHOICE

1. ANS: D DIF: Medium REF: 416-417 OBJ: 6.16.4.1
TOP: monetary policy
2. ANS: C DIF: Medium REF: 422 OBJ: 6.16.4.1
TOP: monetary policy
3. ANS: D DIF: Medium REF: 414 OBJ: 6.16.1.1
TOP: monetary policy
4. ANS: C DIF: Medium REF: 433 OBJ: 6.16.4.2
TOP: monetary policy
5. ANS: A DIF: Medium REF: 428 OBJ: 6.16.3.2
TOP: discount rate
6. ANS: C DIF: Medium REF: 417 OBJ: 6.16.1.1
TOP: federal reserve district
7. ANS: A DIF: Medium REF: 421 OBJ: 6.16.2.2
TOP: discount rate
8. ANS: B DIF: Medium REF: 431 OBJ: 6.16.3.2
TOP: tight money policy
9. ANS: A DIF: Medium REF: 427 OBJ: 6.16.3.2
TOP: excess reserves
10. ANS: B DIF: Medium REF: 420 OBJ: 6.16.2.1
TOP: federal reserve system
11. ANS: C DIF: Medium REF: 431 OBJ: 6.16.3.2
TOP: easy money policy
12. ANS: D DIF: Medium REF: 431 OBJ: 6.16.4.1
TOP: easy money policy
13. ANS: D DIF: Easy REF: 418 OBJ: 6.16.1.3
TOP: federal open market committee
14. ANS: C DIF: Medium REF: 426 OBJ: 6.16.3.1
TOP: money multiplier, required reserve ratio
15. ANS: D DIF: Medium REF: 426 OBJ: 6.16.3.1
TOP: money multiplier, required reserve ratio
16. ANS: B DIF: Easy REF: 427 OBJ: 6.16.3.1
TOP: excess reserves
17. ANS: C DIF: Easy REF: 417 OBJ: 6.16.1.3
TOP: federal reserve
18. ANS: C DIF: Medium REF: 427, 428 OBJ: 6.16.3.2
TOP: federal reserve
19. ANS: C DIF: Medium REF: 429 OBJ: 6.16.3.3
TOP: open market operations
20. ANS: A DIF: Easy REF: 428 OBJ: 6.16.3.2
TOP: discount rate
21. ANS: D DIF: Easy REF: 431 OBJ: 6.16.4.1
TOP: tight money policy
22. ANS: B DIF: Hard REF: 416 OBJ: 6.16.1.1

	TOP:	great depression, federal reserve						
23.	ANS:	B	DIF:	Medium	REF:	427	OBJ:	6.16.3.2
	TOP:	monetary policy						
24.	ANS:	A	DIF:	Hard	REF:	426	OBJ:	6.16.3.1
	TOP:	money multiplier, required reserve ratio						
25.	ANS:	A	DIF:	Easy	REF:	423	OBJ:	6.16.2.4
	TOP:	interest rate, demand for money						
26.	ANS:	C	DIF:	Medium	REF:	432	OBJ:	6.16.4.2
	TOP:	inside lag						

MATCHING

27.	ANS:	B	DIF:	Easy	REF:	425	OBJ:	6.16.3.1
	TOP:	required reserve ratio						
28.	ANS:	D	DIF:	Easy	REF:	428	OBJ:	6.16.3.2
	TOP:	open market operations						
29.	ANS:	H	DIF:	Easy	REF:	422	OBJ:	6.16.2.2
	TOP:	federal funds rate						
30.	ANS:	F	DIF:	Easy	REF:	431	OBJ:	6.16.4.1
	TOP:	easy money policy						
31.	ANS:	C	DIF:	Easy	REF:	421	OBJ:	6.16.2.2
	TOP:	check clearing						
32.	ANS:	I	DIF:	Easy	REF:	416	OBJ:	6.16.1.1
	TOP:	board of governors						
33.	ANS:	E	DIF:	Easy	REF:	422	OBJ:	6.16.2.3
	TOP:	net worth						
34.	ANS:	A	DIF:	Easy	REF:	427	OBJ:	6.16.3.2
	TOP:	prime rate						

35.	ANS:	C	DIF:	Easy	REF:	425	OBJ:	6.16.3.1
	TOP:	money creation						
36.	ANS:	D	DIF:	Easy	REF:	432	OBJ:	6.16.4.2
	TOP:	inside lag						
37.	ANS:	J	DIF:	Easy	REF:	428	OBJ:	6.16.3.3
	TOP:	monetarism						
38.	ANS:	I	DIF:	Easy	REF:	421	OBJ:	6.16.2.1
	TOP:	bank holding company						
39.	ANS:	E	DIF:	Easy	REF:	432	OBJ:	6.16.4.2
	TOP:	outside lag						
40.	ANS:	G	DIF:	Easy	REF:	417	OBJ:	6.16.1.1
	TOP:	monetary policy						
41.	ANS:	A	DIF:	Easy	REF:	422	OBJ:	6.16.2.2
	TOP:	discount rate						
42.	ANS:	F	DIF:	Easy	REF:	418	OBJ:	6.16.1.3
	TOP:	federal advisory council (fac)						

SHORT ANSWER

43. ANS:
Fiscal policy includes changes in government spending and taxation, whereas monetary policy includes actions that alter the supply of money.

DIF: Hard REF: 434 OBJ: 6.16.4.4 TOP: fiscal policy, monetary policy

44. ANS:
expansionary

DIF: Hard REF: 434 OBJ: 6.16.4.4 TOP: fiscal policy, expansionary policy

45. ANS:
the Federal Reserve

DIF: Hard REF: 434 OBJ: 6.16.1.1 TOP: monetary policy

46. ANS:
the federal government

DIF: Hard REF: 434 OBJ: 6.16.4.4 TOP: fiscal policy

47. ANS:
expansionary policy

DIF: Hard REF: 434 OBJ: 6.16.4.4 TOP: monetary policy, easy money policy

48. ANS:
It increases government spending and cuts taxes.

DIF: Hard REF: 434 OBJ: 6.16.4.4
TOP: expansionary fiscal policy, monetary policy

ESSAY

49. ANS:
The Federal Reserve decreases the money supply by selling government bonds on the open market. The money they receive for the bonds is then withdrawn from the market, so the money supply is lowered.

DIF: Hard REF: 428 OBJ: 6.16.3.2
TOP: open market operations, tight money policy

50. ANS:
The money multiplier works by figuring out the amount of total money that will be generated when money keeps being taken in by a bank and lent out again, so that in each successive case only a small percentage of the money is withdrawn to be a reserve against the deposit.

DIF: Hard REF: 426 OBJ: 6.16.3.1 TOP: money multiplier formula

51. ANS:
Inside lags are the time it takes to implement policy, including the time it takes to identify a problem and the time it takes to implement the policy. Outside lags are the time it takes for an implemented policy to become effective, either through new government spending and tax policies or the changes in business that come about through new policy.

DIF: Hard REF: 432 OBJ: 6.16.4.2 TOP: inside lag, outside lag

52. ANS:

The four factors that determine how much money a company or individual holds are: (1) cash needed on hand, (2) interest rates, (3) price levels in the economy, and (4) general level of income.

DIF: Hard REF: 422 OBJ: 6.16.2.3 TOP: monetary policy

53. ANS:
The Federal Reserve buys government securities, pays for them with Federal Reserve Funds, and the money is deposited in the bank. As these funds enter the banking system, they set in motion the money creation process.

DIF: Hard REF: 428 OBJ: 6.16.3.1
TOP: open market operations, easy money policy

54. ANS:
The Federal Reserve uses the open market operations much more freely because changing the reserve requirements would disrupt banking, and making the discount rate different from other interest rates would encourage excess borrowing by member banks.

DIF: Hard REF: 429 OBJ: 6.16.3.2 TOP: open market operations