

ANSWER OUTLINE

ECONOMICS 353

L. Tesfatsion/Fall 2007

EXERCISE 3: 6 Questions (8 Points Total)

DUE: Tues., Sept 18, 2007, 2:10pm

****IMPORTANT REMINDER: LATE ASSIGNMENTS WILL NOT BE ACCEPTED
– NO EXCEPTIONS****

EXERCISE INSTRUCTIONS:

- (1) Please **fill in your name and student ID number** on Side 1 of your bubble sheet and write **353 Exercise 3** in the top margin of Side 1.
- (2) Use a number 2 pencil to **mark your answers** on Side 1 of the bubble sheet to the first five questions Q1 through Q5, below, which are in multiple choice format.
- (3) The sixth question Q6 asks you to explore what happens to money deposited in local Ames banks or credit unions. Please put your **name and student ID number** at the top of your answer sheet for Q6 along with **353 Exercise 3** and **separately** hand in this answer-sheet for Q6 in addition to your answer bubble sheet for questions Q1 through Q5.
- (4) Each question Q1 through Q5 is worth 1 point, and Q6 is worth 3 points.

Q1 (1 point). The organization responsible for the conduct of MONETARY POLICY in the United States is

- A. the executive branch (the President and his administration).
- B B. the Federal Reserve System.
- C. the Office of the Comptroller.
- D. the U.S. Treasury.
- E. the U.S. Congress.

Q2 (1 Point). CHECKABLE DEPOSIT ACCOUNTS supplied by reputable U.S. commercial banks such as the First National Bank in Ames

- A. are legal tender in the U.S.
- B. are a generally accepted means of payment for goods and services and for repayment of debts in the U.S., by social custom.
- C. constitute part of M1, a commonly used measure of money in the U.S.
- D. All of the above.
- E E. Only B and C.

Q3 (1 Point). When compared to exchange systems that rely on money, DISADVANTAGES of the barter payment system include:

- A. lower transactions costs.
- B B.** the discouragement of labor specialization (division of labor).
- C. the encouragement of labor specialization (division of labor).
- D. the requirement that double coincidence of wants be absent.
- E. both C and D.

Q4 (1 Point). U.S. monetary policy makers worry about being able to accurately measure and control the money supply held in the private sector because

- A. changes in this money supply induced by taxes and expenditures can be used to exert control over the government budget deficit.
- B. changes in this money supply induced by printing press operations can be used to exert control over the inflation rate.
- C C.** changes in this money supply induced through “open market operations” (bond sales to the private sector) can be used to exert control over interest rates.
- D. changes in this money supply induced through current account operations can be used to exert control over the balance of payments.

Q5 (1 Point). Which of the following statements are TRUE:

- A. Initial estimates of the aggregate money measures M1, M2, and M3 are rarely revised, so they are reliable guides to short-run movements in the money supply.
- B. M3 is the most commonly used aggregate money measure in the U.S. because the financial instruments it contains are all highly liquid.
- C. M1, M2 and M3 always move closely together.
- D D.** M1 is the narrowest of the three aggregate money measures M1, M2, and M3, in the sense that it consists of financial instruments that most closely satisfy the theoretical definition of money.
- E. All of the above.

**SEE THE FOLLOWING PAGE FOR
Q6: WEB EXERCISE**

Q6: Web Exercise (3 Points Total). Follow the Money!

In the following discussion, “your bank” is a general reference to any commercial bank or credit union in Ames in which you, yourself, hold a deposit account. If you do NOT yourself have a deposit account in any commercial bank or credit union in Ames, then choose one of the following Ames establishments as “your bank” for the purposes of Q6:

- First National Bank (any Ames branch)
- Wells Fargo Bank (any Ames branch)
- Ames Community Bank (any Ames branch)
- First American Bank (any Ames branch)
- Valley Bank (any Ames Branch)
- Midwest Heritage Bank (any Ames branch)
- Bank of the West (any Ames branch)

This question asks you to research and report on the uses that “your bank” makes of deposit accounts, and the policies that “your bank” has in place (if any) to protect against moral hazard problems.

Please be sure to provide the complete address of “your bank”, the name of any bank or credit union personnel you speak with, and the URL address for any website you use to research the answers to parts A & B below. Any quoted materials should be included within quotes, and the name of the person(s) making the quoted statement(s) should be given along with the date(s) on which the quoted material was recorded.

Your answers to Q6:Parts A & B below should be provided on answer sheets (no more than two pages) that are stapled together (if necessary) and separately turned in along with your bubble sheet with answers to Q1-Q5 above. Your answers to Q6:Parts A & B will be judged to be satisfactory if evidence is provided that a good-faith effort was made to obtain the requested information, and the provided information summaries are carefully expressed and demonstrate a basic understanding of financial intermediation, moral hazard, and the ways in which moral hazard problems can arise for financial intermediaries.

Part A [1.5 Points]: USE OF DEPOSIT ACCOUNT FUNDS Make an appointment to speak with one or more personnel at your bank regarding the uses that your bank makes of its customers’ deposit account funds. For example, if your bank uses these funds for lending, what kinds of loans does the bank provide, and to whom? Check to see if your bank has any written materials regarding its use of deposit account funds that you might acquire. Also check to see if your bank provides information regarding its use of deposit account funds at a publicly accessible website.

Write up a careful concise summary (no more than 1 typed page) of what you find out for Part A.

Part B [1.5 Points]: MORAL HAZARD PROTECTIONS Using the same sources of information as for Part A (i.e., interviews, written materials, and/or websites), try to find out as much as you can regarding the policies your bank has in place (if any) to protect itself and its customers against moral hazard problems. For example, if your bank loans out its deposit account funds to firms, what steps (if any) does it take to ensure that these firms exercise prudence in the uses they make of these borrowed funds? And what steps does your bank take (if any) to assure its deposit account holders that it will exercise prudence with regard to the uses it makes of their deposit account funds?

Write up a careful concise summary (no more than 1 typed page) of what you find out for Part B.