I. Multiple Choice

1. The members of the Board of Governors of the Federal Reserve are appointed by the __.
   A. directors of the Federal Reserve regional banks
   B. Federal Advisory Council
   C. President of the U.S.
   D. presidents of the Federal Reserve regional banks

2. Which one of the following statements about the Chairman of the Board of Governors of the Federal Reserve System is not true?
   A. The chairman is automatically a member of the President’s Council of Economic Advisors.
   B. The chairman’s four-year term does not coincide with the presidential term.
   C. Technically, the chairman has only one vote on the Federal Open Market Committee.
   D. The chairman is the most prominent member of the Federal Open Market Committee.

3. Federal law requires that no two Federal Reserve Board Governors come from the same __.
   A. industry
   B. state
   C. political party
   D. Federal Reserve district

4. Funding for the operations of the Board of Governors of the Federal Reserve is derived from __.
   A. the governments of the states in which the district banks operate
   B. taxes collected from commercial banks
   C. appropriates from the U.S. Congress
   D. Federal Reserve district banks

5. Each regional Federal Reserve bank is owned by __.
   A. those who purchase its stock on the open market
   B. the member banks in its district
   C. the taxpayers in its district
   D. the Federal Deposit Insurance Corporation

6. The Federal Reserve’s primary monetary policy-making body is the __.
   A. seven member Board of Governors of the Federal Reserve System
   B. Federal Advisory Council
   C. Federal Open Market Committee
   D. Council of Economic Advisors
7. Open market operations are executed through __.
   A. the Federal Reserve Bank of New York
   B. different Federal Reserve district banks depending on regional objectives
   C. the U.S. Treasury
   D. the Federal Open Market Committee

8. Which one of the following is a true statement about the President of the New York Federal Reserve Bank?
   A. The president of the NY Federal Reserve Bank has a standing equal to all other district bank presidents.
   B. By law the salary of the president of the NY Federal Reserve Bank can be no more than 75% of the salary of the Chairman of the Board of Governors.
   C. The president of the NY Federal Reserve Bank has less standing than other district bank presidents because s/he is not a voting member of the FOMC.
   D. The president of the NY Federal Reserve Bank has a more powerful position than any other district bank president in part because of the special importance of the FRB-NY and because s/he is a permanent voting member of the FOMC.

9. Which of the following is often used by opponents of Federal Reserve independence?
   A. Independence causes inflationary pressures to build because of excessive monetary growth.
   B. Independence leads to conflicts between monetary and fiscal policy.
   C. Independence slows the policy decision process.
   D. Independence causes a concentration of financial power.

10. In most countries, the central bank is __.
    A. totally autonomous from the rest of the government
    B. semi-independent from the rest of the government
    C. subordinate to the rest of the government
    D. a part of the private sector

II. Short Answer
11. Below you are given a simplified bank balance sheet for a commercial bank. Assume that the reserve requirement for this bank is 20%.

<table>
<thead>
<tr>
<th>Local National Bank</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
</tr>
<tr>
<td>Reserves</td>
</tr>
<tr>
<td>$800,000</td>
</tr>
<tr>
<td>Government Securities</td>
</tr>
<tr>
<td>$1,100,000</td>
</tr>
<tr>
<td>Other Securities</td>
</tr>
<tr>
<td>$300,000</td>
</tr>
<tr>
<td>Loans</td>
</tr>
<tr>
<td>$1,300,000</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
</tr>
<tr>
<td>$3,300,000</td>
</tr>
</tbody>
</table>

A. The amount of required reserves is $612,000.
B. The amount of excess reserves is $188,000.

C. Suppose the Local National Bank now made a business loan of $75,000. (The normal way for such a loan to be made is for the bank to open a checking account for the borrower). What would be the immediate effect of this loan be on the balance sheet items shown above? Note the items which would change, by how much they would change, and whether they would be decreases (-) or increases (+).

- **Assets**: loans would increase by $75,000
- **Liability**: demand deposits would increase by $75,000

D. The borrower now uses the full amount of his loan to pay Smith, who deposits it in the Jackson State Bank. What is the effect of the check clearance on the Local National Bank’s balance sheet items?

- **Reserves** would fall by $75,000

E. Fill in a new balance sheet for the Local National Bank, incorporating the changes caused by the transactions in questions C and D above.

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities &amp; Net Worth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reserves</td>
<td>$725,000</td>
</tr>
<tr>
<td>Government Securities</td>
<td>$1,100,000</td>
</tr>
<tr>
<td>Other Securities</td>
<td>$300,000</td>
</tr>
<tr>
<td>Loans</td>
<td>$1,375,000</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>$3,500,000</strong></td>
</tr>
</tbody>
</table>

F. Returning to the initial figures given in the first balance sheet, suppose the bank has expanded its loans by $940,000. This would have increased demand deposits to $4,000,000 so that its reserves would have been just 20% of demand deposits, the minimum set by the Fed. This would be a very foolish banking policy. Explain why.

- Lose reserves by $940,000: Bank cannot safely lend (or buy securities) for more than its excess reserves.

G. In the initial situation, as the balance sheet originally appeared above, the maximum amount the bank could safely expand its loans is $188,000 (amt of excess reserves available)

H. What is the very important banking principle illustrated by the above question? Explain this principle with respect to Local National Bank.

- Can’t lend more than excess reserves! Local National Bank’s loans less than $188,000