MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

1) A corporation acquires new funds only when its securities are sold in the
   A) primary market by an investment bank.
   B) primary market by a stock exchange broker.
   C) secondary market by a commercial bank.
   D) secondary market by a securities dealer.

2) Which of the following is not a goal of financial regulation?
   A) Reducing moral hazard
   B) Reducing adverse selection
   C) Ensuring that investors never suffer losses
   D) Ensuring the soundness of the financial system

3) If peanuts serve as a medium of exchange, a unit of account, and a store of value, then peanuts are
   A) bank deposits. B) money. C) loanable funds. D) reserves.

4) Which of the following statements about financial markets and securities is true?
   A) The maturity of a debt instrument is the number of years (term) to that instrument’s expiration date.
   B) A debt instrument is intermediate term if its maturity is less than one year.
   C) A bond is a long-term security that promises to make periodic payments called dividends to the firm’s residual claimants.
   D) A debt instrument is intermediate term if its maturity is ten years or longer.

5) _______ is the relative ease and speed with which an asset can be converted into a medium of exchange.
   A) Efficiency B) Liquidity C) Deflation D) Specialization

6) An investment intermediary that lends funds to consumers is
   A) a finance company. B) a consumer company. C) an investment bank. D) a finance fund.

7) A goal of the Securities and Exchange Commission is to reduce problems arising from
   A) competition. B) asymmetric information. C) risk. D) banking panics.

8) Well-functioning financial markets
   A) produce an efficient allocation of capital. B) cause financial crises.
   C) eliminate the need for indirect finance. D) cause inflation.

9) Evidence from business cycle fluctuations in the United States indicates that
   A) recessions have been preceded by dollar depreciation.
   B) recessions have been preceded by declines in share prices on the stock exchange.
   C) a negative relationship between money growth and general economic activity exists.
   D) recessions have been preceded by a decline in the growth rate of money.
10) If there are five goods in a barter economy, one needs to know ten prices in order to exchange one good for another. If, however, there are ten goods in a barter economy, then one needs to know _______ prices in order to exchange one good for another.

A) 20  B) 25  C) 30  D) 45

11) Equity holders are a corporation's _______. That means the corporation must pay all of its debt holders before it pays its equity holders.

A) debtors  B) brokers  C) underwriters  D) residual claimants

12) The process of indirect finance using financial intermediaries is called

A) financial intermediation.  B) financial liquidation.  C) resource allocation.  D) direct lending.

13) Financial institutions that accept deposits and make loans are called ______.

A) exchanges  B) banks  C) over-the-counter markets  D) finance companies

14) The time and money spent in carrying out financial transactions are called

A) financial intermediation.  B) economies of scale.  C) liquidity services.  D) transaction costs.

15) Financial markets promote economic efficiency by

A) channeling funds from savers to investors.  B) reducing investment.  C) creating inflation.  D) channeling funds from investors to savers.

16) An important financial institution that assists in the initial sale of securities in the primary market is the


17) Which of the following financial intermediaries is not a depository institution?

A) A credit union  B) A commercial bank  C) A savings and loan association  D) A finance company

18) The primary purpose of deposit insurance is to

A) protect bank shareholders against losses.  B) prevent banking panics.  C) protect bank employees from unemployment.  D) improve the flow of information to investors.
19) Evidence from the United States and other foreign countries indicates that
   A) there is a strong positive association between inflation and growth rate of money over long periods of time.
   B) countries with low monetary growth rates tend to experience higher rates of inflation, all else being constant.
   C) money growth is clearly unrelated to inflation.
   D) there is little support for the assertion that "inflation is always and everywhere a monetary phenomenon."

20) Which of the following can be described as direct finance?
   A) You buy shares in a mutual fund.
   B) You take out a mortgage from your local bank.
   C) You buy shares of common stock in the secondary market.
   D) You borrow $2500 from a friend.

21) The organization responsible for the conduct of monetary policy in the United States is the

22) The bond markets are important because they are
   A) the markets where all borrowers get their funds.
   B) the markets where interest rates are determined.
   C) the markets where foreign exchange rates are determined.
   D) easily the most widely followed financial markets in the United States.

23) Long-term debt has a maturity that is ________.
   A) less than a year.  B) between five and ten years.
   C) between one and ten years.  D) ten years or longer.

24) Even economists have no single, precise definition of money because
   A) the "moneyness" or liquidity of an asset is a matter of degree.
   B) money supply statistics are a state secret.
   C) the Federal Reserve does not employ or report different measures of the money supply.
   D) economists find disagreement interesting and refuse to agree for ideological reasons.

25) Typically, borrowers have superior information relative to lenders about the potential returns and risks associated with an investment project. The difference in information is called
   A) adverse hazard  B) asymmetric information.
   C) moral selection.  D) risk sharing.

26) Financial markets have the basic function of
   A) assuring that the swings in the business cycle are less pronounced.
   B) providing a risk-free repository of spending power.
   C) assuring that governments need never resort to printing money.
   D) getting people with funds to lend together with people who want to borrow funds.

27) A financial market in which only short-term debt instruments are traded is called the ________ market.
   A) money  B) capital  C) stock  D) bond
28) When we say that money is a stock variable, we mean that 
   A) we must attach a time period to the measure. 
   B) it is sold in the equity market. 
   C) the quantity of money is measured at a given point in time. 
   D) money never loses purchasing power.

29) ______ policy involves decisions about government spending and taxation.  
   A) Fiscal  B) Monetary  C) Financial  D) Systemic

30) Which of the following can be described as involving indirect finance? 
   A) A corporation buys a share of common stock issued by another corporation in the primary market. 
   B) You make a loan to your neighbor. 
   C) You buy a U.S. Treasury bill from the U.S. Treasury. 
   D) You make a deposit at a bank.

31) Bonds that are sold in a foreign country and are denominated in a currency other than that of the country in which it is sold are known as 

32) Everything else held constant, a decline in interest rates will cause spending on housing to 
   A) remain unchanged.  B) fall. 
   C) either rise, fall, or remain the same.  D) rise.

33) Which of the following are short-term financial instruments? 
   A) A share of Walt Disney Corporation stock. 
   B) A Treasury note with a maturity of four years. 
   C) A repurchase agreement. 
   D) A residential mortgage.

34) The upward and downward movement of aggregate output produced in the economy is referred to as the ______. 
   A) roller coaster  B) shock wave  C) see saw  D) business cycle

35) A liquid asset is 
   A) a share of an ocean resort. 
   B) always sold in an over-the-counter market. 
   C) an asset that can easily and quickly be sold to raise cash. 
   D) difficult to resell.

36) Bonds that are sold in a foreign country and are denominated in the country’s currency in which they are sold are known as 

37) Budget deficits are important because deficits 
   A) can result in higher rates of monetary growth. 
   B) cause bank failures. 
   C) always cause interest rates to fall. 
   D) always cause prices to fall.
38) The stock market is important because it is
   A) the most widely followed financial market in the United States.
   B) where interest rates are determined.
   C) where foreign exchange rates are determined.
   D) the market where most borrowers get their funds.

39) The evolution of the payments system from barter to precious metals, then to fiat money, then to checks can best be understood as a consequence of
   A) government regulations designed to promote the safety of the payments system.
   B) competition among firms to make it easier for customers to purchase their products.
   C) innovations that reduced the costs of exchanging goods and services.
   D) government regulations designed to improve the efficiency of the payments system.

40) An investment bank purchases securities from a corporation at a predetermined price and then resells them in the market. This process is called
   A) underhanded.  B) undertaking.  C) underwriting.  D) understanding.

41) An important function of secondary markets is to
   A) create a market for newly constructed houses.
   B) raise funds for corporations through the sale of securities.
   C) make it easier to sell financial instruments to raise funds.
   D) make it easier for governments to raise taxes.

42) U.S. dollar deposits in foreign banks outside the U.S. or in foreign branches of U.S. banks are called
   A) outside dollars  B) foreign dollars  C) Eurodollars  D) Atlantic dollars

43) When stock prices fall
   A) a business firm will be more likely to sell stock to finance investment spending.
   B) an individual’s wealth is not affected nor is their willingness to spend.
   C) an individual’s wealth may decrease and their willingness to spend may decrease.
   D) an individual’s wealth may decrease but their willingness to spend is not affected.

44) Collateral is ______ the lender receives if the borrower does not pay back the loan.
   A) an asset  B) a present  C) an offering  D) a liability

45) Financial intermediaries
   A) can hurt the performance of the economy.
   B) hold very little of the average American’s wealth.
   C) provide a channel for linking those who want to save with those who want to invest.
   D) produce nothing of value and are therefore a drain on society’s resources.

46) Sustained downward movements in the business cycle are referred to as
   A) economic recoveries.  B) expansions.
   C) recessions.  D) inflation.
47) An example of the problem of _______ is when a corporation uses the funds raised from selling bonds to fund corporate expansion to pay for Caribbean cruises for all of its employees and their families.
   A) adverse selection
   B) risk sharing
   C) credit risk
   D) moral hazard

48) U.S. Treasury bills are considered the safest of all money market instruments because there is no risk of _______.
   A) defeat
   B) default
   C) demarcation
   D) desertion

49) When money prices are used to facilitate comparisons of value, money is said to function as a _______.
   A) unit of account.
   B) store of value.
   C) payments-system ruler.
   D) medium of exchange.

50) The conversion of a barter economy to one that uses money
   A) increases efficiency by reducing transactions costs.
   B) does not increase economic efficiency.
   C) increases efficiency by reducing the need to exchange goods and services.
   D) increases efficiency by reducing the need to specialize.
1) A
2) C
3) B
4) A
5) B
6) A
7) B
8) A
9) D
10) D
11) D
12) A
13) B
14) D
15) A
16) B
17) D
18) B
19) A
20) D
21) A
22) B
23) D
24) A
25) B
26) D
27) A
28) C
29) A
30) D
31) D
32) D
33) C
34) D
35) C
36) B
37) A
38) A
39) C
40) C
41) C
42) C
43) C
44) A
45) C
46) C
47) D
48) B
49) A
50) A