

# Chapter 12

## Structure of Central Banks and the Federal Reserve System

### 12.1 Origins of the Federal Reserve System

1) The First Bank of the United States

- A) was disbanded in 1811 when its charter was not renewed.
- B) had its charter renewal vetoed in 1832.
- C) was fundamental in helping the Federal Government finance the War of 1812.
- D) None of the above.

Answer: A

*Ques Status: New*

2) The Second Bank of the United States

- A) was disbanded in 1811 when its charter was not renewed.
- B) had its charter renewal vetoed in 1832.
- C) is considered to be the primary cause of the bank panic of 1907.
- D) None of the above.

Answer: B

*Ques Status: New*

3) The public's fear of centralized power and distrust of moneyed interests led to the demise of the first two experiments in central banking:

- A) the First Bank of the United States and the Second Bank of the United States.
- B) the First Bank of the United States and the Central Bank of the United States.
- C) the First Central Bank of the United States and the Second Central Bank of the United States.
- D) the First Bank of North America and the Second Bank of North America.

Answer: A

*Ques Status: Revised*

4) The financial panic of 1907 resulted in such widespread bank failures and substantial losses to depositors that the American public finally became convinced that

- A) the First Bank of the United States had failed to serve as a lender of last resort.
- B) the Second Bank of the United States had failed to serve as a lender of last resort.
- C) the Federal Reserve System had failed to serve as a lender of last resort.
- D) a central bank was needed to prevent future panics.

Answer: D

*Ques Status: Previous Edition*

- 5) What makes the Federal Reserve so unique compared to other central banks around the world is its
- A) centralized structure.
  - B) decentralized structure.
  - C) regulatory functions.
  - D) monetary policy functions.

Answer: B

*Ques Status: New*

## 12.2 Structure of the Federal Reserve System

- 1) Which of the following is **NOT** an entity of the Federal Reserve System?
- A) Federal Reserve Banks
  - B) The Comptroller of the Currency
  - C) The Board of Governors
  - D) The Federal Open Market Committee

Answer: B

*Ques Status: Revised*

- 2) Which of the following is an entity of the Federal Reserve System?
- A) The U.S. Treasury Secretary
  - B) The FOMC
  - C) The Comptroller of the Currency
  - D) The FDIC

Answer: B

*Ques Status: New*

- 3) The three largest Federal Reserve banks (New York, Chicago, and San Francisco) combined hold more than \_\_\_\_\_ percent of the assets of the Federal Reserve System.
- A) 25
  - B) 33
  - C) 50
  - D) 67

Answer: C

*Ques Status: New*

- 4) Each Federal Reserve bank has nine directors. Of these \_\_\_\_\_ are appointed by the member banks and \_\_\_\_\_ are appointed by the Board of Governors.
- A) three; six
  - B) four; five
  - C) five; four
  - D) six; three

Answer: D

*Ques Status: New*

- 5) Member commercial banks have purchased stock in their district Fed banks; the dividend paid by that stock is limited by law to \_\_\_\_\_ percent annually.
- A) four
  - B) five
  - C) six
  - D) eight

Answer: C

*Ques Status: Revised*

- 6) The Federal Reserve Bank of \_\_\_\_\_ plays a special role in the Federal Reserve System because it houses the open market desk.
- A) Boston
  - B) New York
  - C) Chicago
  - D) San Francisco

Answer: B

*Ques Status: New*

- 7) The president from which Federal Reserve Bank always has a vote in the Federal Open Market Committee?
- A) Philadelphia
  - B) Boston
  - C) San Francisco
  - D) New York

Answer: D

*Ques Status: Previous Edition*

8) An important function of the regional Federal Reserve Banks is

- A) setting reserve requirements.
- B) clearing checks.
- C) determining monetary policy.
- D) setting margin requirements.

Answer: B

*Ques Status: Revised*

9) Which of the following functions are not performed by any of the twelve regional Federal Reserve Banks?

- A) Check clearing
- B) Conducting economic research
- C) Setting interest rates payable on time deposits
- D) Issuing new currency

Answer: C

*Ques Status: Previous Edition*

10) All \_\_\_\_\_ are required to be members of the Fed.

- A) state chartered banks
- B) nationally chartered banks
- C) banks with assets less than \$100 million
- D) banks with assets less than \$500 million

Answer: B

*Ques Status: Previous Edition*

11) Of all commercial banks, about \_\_\_\_\_ percent belong to the Federal Reserve System.

- A) 15
- B) 20
- C) 33
- D) 50

Answer: C

*Ques Status: Revised*

12) Prior to 1980, member banks left the Federal Reserve System due to

- A) the high cost of discount loans.
- B) the high cost of required reserves.
- C) a desire to avoid interest rate regulations.
- D) a desire to avoid credit controls.

Answer: B

*Ques Status: Revised*

13) The Fed's support of the Depository Institutions Deregulation and Monetary Control Act of 1980 stemmed in part from its

- A) concern over declining Fed membership.
- B) belief that all banking regulations should be eliminated.
- C) belief that interest rate ceilings were too high.
- D) belief that depositors had to become more knowledgeable of banking operations.

Answer: A

*Ques Status: Previous Edition*

14) Banks subject to reserve requirements set by the Federal Reserve System include

- A) only nationally chartered banks.
- B) only banks with assets less than \$100 million.
- C) only banks with assets less than \$500 million.
- D) all banks whether or not they are members of the Federal Reserve System.

Answer: D

*Ques Status: Revised*

15) The Depository Institutions Deregulation and Monetary Control Act of 1980

- A) established higher reserve requirements for nonmember than for member banks.
- B) established higher reserve requirements for member than for nonmember banks.
- C) abolished reserve requirements.
- D) established uniform reserve requirements for all banks.

Answer: D

*Ques Status: Revised*

16) There are \_\_\_\_\_ members of the Board of Governors of the Federal Reserve System.

- A) 5
- B) 7
- C) 12
- D) 19

Answer: B

*Ques Status: New*

17) Members of the Board of Governors are

- A) chosen by the Federal Reserve Bank presidents.
- B) appointed by the newly elected president of the United States, as are cabinet positions.
- C) appointed by the president of the United States and confirmed by the Senate as members resign.
- D) never allowed to serve more than 7-year terms.

Answer: C

*Ques Status: Previous Edition*

18) Each governor on the Board of Governors can serve

- A) only one nonrenewable fourteen-year term.
- B) one full nonrenewable fourteen-year term plus part of another term.
- C) only one nonrenewable eight-year term.
- D) one full nonrenewable eight-year term plus part of another term.

Answer: B

*Ques Status: New*

19) The Chairman of the Board of Governors is chosen from among the seven governors and serves a \_\_\_\_\_ term.

- A) one-year
- B) two-year
- C) four-year
- D) eight-year

Answer: C

*Ques Status: New*

- 20) While the discount rate is "established" by the regional Federal Reserve Banks, in truth, the rate is determined by
- A) Congress.
  - B) the president of the United States.
  - C) the Senate.
  - D) the Board of Governors.

Answer: D

*Ques Status: Revised*

- 21) Which of the following are duties of the Board of Governors of the Federal Reserve System?
- A) Setting margin requirements, the fraction of the purchase price of the securities that has to be paid for with cash
  - B) Setting the maximum interest rates payable on certain types of time deposits under Regulation Q
  - C) Regulating credit with the approval of the president under the Credit Control Act of 1969
  - D) All governors advise the president of the United States on economics policy.

Answer: A

*Ques Status: Revised*

- 22) Which of the following are not current duties of the Board of Governors of the Federal Reserve System?
- A) Setting margin requirements, the fraction of the purchase price of the securities that has to be paid for with cash
  - B) Setting the maximum interest rates payable on certain types of time deposits under Regulation Q
  - C) Approving the discount rate "established" by the Federal Reserve banks
  - D) Representing the United States in negotiations with foreign governments on economic matters

Answer: B

*Ques Status: Revised*

- 23) The Federal Open Market Committee usually meets \_\_\_\_\_ times a year.
- A) four
  - B) six
  - C) eight
  - D) twelve

Answer: C

*Ques Status: New*

- 24) The Federal Reserve entity that makes decisions regarding the conduct of open market operations is the
- A) Board of Governors.
  - B) chairman of the Board of Governors.
  - C) Federal Open Market Committee.
  - D) Open Market Advisory Council

Answer: C

*Ques Status: Revised*

- 25) The Federal Open Market Committee consists of the
- A) five senior members of the seven-member Board of Governors.
  - B) seven members of the Board of Governors and seven presidents of the regional Fed banks.
  - C) seven members of the Board of Governors and five presidents of the regional Fed banks.
  - D) twelve regional Fed bank presidents and the chairman of the Board of Governors.

Answer: C

*Ques Status: Revised*

- 26) The majority of members of the Federal Open Market Committee are
- A) Federal Reserve Bank presidents.
  - B) members of the Federal Advisory Council.
  - C) presidents of member banks.
  - D) the seven Federal Reserve governors.

Answer: D

*Ques Status: Revised*

- 27) Each Fed bank president attends FOMC meetings; although only \_\_\_\_\_ Fed bank presidents vote on policy, all \_\_\_\_\_ provide input.
- A) three; ten
  - B) five; ten
  - C) three; twelve
  - D) five; twelve

Answer: D

*Ques Status: Previous Edition*

- 28) Although neither \_\_\_\_\_ nor the \_\_\_\_\_ are officially set by the Federal Open Market Committee, decisions concerning these policy tools are effectively made by the committee.
- A) margin requirements; discount rate
  - B) margin requirements; federal funds rate
  - C) reserve requirements; discount rate
  - D) reserve requirements; federal funds rate

Answer: C

*Ques Status: Previous Edition*

- 29) The research document given to the Federal Open Market Committee that contains information on the state of the economy in each Federal Reserve district is called the
- A) beige book.
  - B) green book.
  - C) blue book.
  - D) black book.

Answer: A

*Ques Status: Revised*

- 30) The research document given to the Federal Open Market Committee that contains the forecast of national economic variables for the next two years is called the
- A) beige book.
  - B) green book.
  - C) blue book.
  - D) black book.

Answer: B

*Ques Status: New*

- 31) The research document given to the Federal Open Market Committee that contains forecasts of the money aggregates conditional on different monetary policy stances is called the
- A) beige book.
  - B) green book.
  - C) blue book.
  - D) black book.

Answer: C

*Ques Status: New*

- 32) The Federal Open Market Committee's "balance of risks" is an assessment of whether, in the future, its primary concern will be
- A) higher exchange rates or higher unemployment.
  - B) higher inflation or a stronger economy.
  - C) higher inflation or a weaker economy.
  - D) lower inflation or a stronger economy.

Answer: C

*Ques Status: Revised*

- 33) Why does the Federal Reserve Bank of New York play a special role within the Federal Reserve System?

Answer: The New York district contains the largest banks in the country. The New York Fed supervises and examines these banks to insure their soundness and the safety of the nation's financial system. The New York Fed conducts open market operations and foreign exchange transactions for the Fed and Treasury. The New York Fed belongs to the Bank for International Settlements, so its president and the chairman of the Board of Governors represent the U.S. at the monthly meetings of the world's central banks. The New York Fed president is the only president of a regional Fed who is a permanent voting member of the FOMC.

*Ques Status: Previous Edition*

- 34) Who are the voting members of the Federal Open Market Committee and why is this committee important? Where does the power lie within this committee?

Answer: The FOMC determines the monetary policy of the United States through its decisions about open market operations. It also effectively determines the discount rate and reserve requirements. The seven members of the Board of Governors, the president of the New York Fed, and four of the other eleven regional bank presidents are voting members on a rotating basis. Within the FOMC, the chairman of the Board of Governors wields the power.

*Ques Status: Previous Edition*

### 12.3 How Independent is the Fed?

- 1) Instrument independence is the ability of \_\_\_\_\_ to set monetary policy \_\_\_\_\_.
- A) the central bank; goals
  - B) Congress; goals
  - C) Congress; instruments
  - D) the central bank; instruments

Answer: D

*Ques Status: Revised*

- 2) The ability of a central bank to set monetary policy instruments is
- A) political independence.
  - B) goal independence.
  - C) policy independence.
  - D) instrument independence.

Answer: D

*Ques Status: Revised*

- 3) Goal independence is the ability of \_\_\_\_\_ to set monetary policy \_\_\_\_\_.
- A) the central bank; goals
  - B) Congress; goals
  - C) Congress; instruments
  - D) the central bank; instruments

Answer: A

*Ques Status: Revised*

- 4) The ability of a central bank to set monetary policy goals is
- A) political independence.
  - B) goal independence.
  - C) policy independence.
  - D) instrument independence.

Answer: B

*Ques Status: Revised*

- 5) Members of Congress are able to influence monetary policy, albeit indirectly, through their ability to
- A) withhold appropriations from the Board of Governors.
  - B) withhold appropriations from the Federal Open Market Committee.
  - C) propose legislation that would force the Fed to submit budget requests to Congress, as must other government agencies.
  - D) instruct the General Accounting Office to audit the foreign exchange market functions of the Federal Reserve.

Answer: C

*Ques Status: Revised*

- 6) Explain two concepts of central bank independence. Is the Fed politically independent? Why do economists think central bank independence is important?

Answer: Instrument independence is the ability of the central bank to set its instruments, and goal independence is the ability of a central bank to set its goals. The Fed enjoys both types of independence. The Fed is largely independent of political pressure due to its earnings and the conditions of appointment of the Board of Governors and its chairman. However, some political pressure can be applied through the threat or enactment of legislation affecting the Fed. Independence is important because there is some evidence that independent central banks pursue lower rates of inflation without harming overall economic performance.

*Ques Status: Previous Edition*

## 12.4 Structure and Independence of the European Central Bank

- 1) Under the European System of Central Banks, the Executive Board is similar in structure to the \_\_\_\_\_ of the Federal Reserve System.

- A) Board of Governors
- B) Federal Open Market Committee
- C) Federal Reserve Banks
- D) Federal Advisory Council

Answer: A

*Ques Status: New*

- 2) Under the European System of Central Banks, the Governing Council is similar in structure to the \_\_\_\_\_ of the Federal Reserve System.

- A) Board of Governors
- B) Federal Open Market Committee
- C) Federal Reserve Banks
- D) Federal Advisory Council

Answer: B

*Ques Status: New*

- 3) Under the European System of Central Banks, the National Central Banks have the same role as the \_\_\_\_\_ of the Federal Reserve System.

- A) Board of Governors
- B) Federal Open Market Committee
- C) Federal Reserve Banks
- D) Federal Advisory Council

Answer: C

*Ques Status: New*

- 4) Members of the Executive Board of the European System of Central Banks are appointed to \_\_\_\_\_ year, nonrenewable terms.
- A) four
  - B) eight
  - C) ten
  - D) fourteen

Answer: B

*Ques Status: New*

- 5) Which of the following statements comparing the European System of Central Banks and the Federal Reserve System is **TRUE**?
- A) The budgets of the Federal Reserve Banks are controlled by the Board of Governors, while the National Central Banks control their own budgets and the budget of the European Central Bank.
  - B) The European Central Bank has similar power over the National Central Banks when compared to the level of power the Board of Governors has over the Federal Reserve Banks.
  - C) Just like the Federal Reserve System, monetary operations are centralized in the European System of Central Banks with the European Central Bank.
  - D) The European Central Bank's involvement in supervision and regulation of financial institutions is comparable to the Board of Governors' involvement.

Answer: A

*Ques Status: New*

- 6) The Governing Council usually meets \_\_\_\_\_ times a year.
- A) four
  - B) six
  - C) eight
  - D) twelve

Answer: D

*Ques Status: New*

- 7) In the Governing Council, the decision of what policy to implement is made by
- A) majority vote of the Executive Board members.
  - B) majority vote of the heads of the National Banks.
  - C) consensus.
  - D) majority vote of all members of the Governing Council.

Answer: C

*Ques Status: New*

- 8) As of the beginning of the year 2006, there are \_\_\_\_\_ countries that have representation on the Governing Council.
- A) six
  - B) eight
  - C) ten
  - D) twelve

Answer: D

*Ques Status: New*

- 9) The central bank which is generally regarded as the most independent in the world because its charter cannot be changed by legislation is the
- A) Bank of England.
  - B) Bank of Canada.
  - C) European Central Bank.
  - D) Bank of Japan.

Answer: C

*Ques Status: Previous Edition*

- 10) Explain the similarities and differences between the European System of Central Banks and the Federal Reserve System.

Answer: The similarities between the two are in their structure. The National Central Banks of the member countries of the Eurosystem have the same role as the Federal Reserve Banks in the Federal Reserve system. The Executive Board and the Governing Council of the Eurosystem resemble the Board of Governors and the Federal Open Market Committee of the Federal Reserve System, respectively. There are three major differences between the two. The first difference is concerning the control of the budgets. In the Fed, the Board of Governors controls the budgets of the Reserve Banks while in the Eurosystem, the National Banks control the budget of the European Central Bank. The second difference is the monetary operations of the Eurosystem are conducted by the National Banks, so they are not as centralized as the monetary operations in the Federal Reserve System. Finally, the European Central Bank is not involved in the supervision and regulation of the financial institutions in the euro zone while the Federal Reserve is involved with the regulation and supervision of the financial institutions in the United States.

*Ques Status: New*

## 12.5 Structure and independence of Other Foreign Central Banks

1) On paper, the Bank of Canada has \_\_\_\_\_ instrument independence and \_\_\_\_\_ goal independence when compared to the Federal Reserve System.

- A) less; less
- B) less; more
- C) more; less
- D) more; more

Answer: A

*Ques Status: New*

2) The oldest central bank, having been founded in 1694, is the

- A) Bank of England.
- B) Deutsche Bundesbank.
- C) Bank of Japan.
- D) Federal Reserve System.

Answer: A

*Ques Status: Previous Edition*

3) While legislation enacted in 1998 granted the Bank of Japan new powers and greater autonomy, its critics contend that its independence is

- A) limited by the Ministry of Finance's veto power over a portion of its budget.
- B) too great because it need not pursue a policy of price stability even if that is the popular will of the people.
- C) too great since the Ministry of Finance no longer has veto power over the bank's budget.
- D) limited since the Ministry of Finance can dismiss senior bank officials.

Answer: A

*Ques Status: Revised*

4) Regarding central bank independence,

- A) the Fed is more independent than the European Central Bank.
- B) the European Central Bank is more independent than the Fed.
- C) the trend in industrialized nations has been to reduce central bank independence.
- D) the Bank of England has the longest tradition of independence of any central bank in the world.

Answer: B

*Ques Status: Revised*

- 5) The trend in recent years is that more and more governments
- A) have been granting greater independence to their central banks.
  - B) have been reducing the independence of their central banks to make them more accountable for poor economic performance.
  - C) have mandated that their central banks focus on controlling inflation.
  - D) have required their central banks to cooperate more with their Ministers of Finance.

Answer: A

*Ques Status: Previous Edition*

- 6) Which of the following statements about central bank structure and independence are true?
- A) In recent years, with the exception of the Bank of England and the Bank of Japan, most countries have reduced the independence of their central banks, subjecting them to greater democratic control.
  - B) Before the Bank of England was granted greater independence, the Federal Reserve was the most independent of the world's central banks.
  - C) Both theory and experience suggest that more independent central banks produce better monetary policy.
  - D) While the European Central Bank is independent, it is not as independent as the Federal Reserve.

Answer: C

*Ques Status: Revised*

## 12.6 Explaining Central Bank Behavior

- 1) The theory of bureaucratic behavior suggests that the objective of a bureaucracy is to maximize
- A) the public's welfare.
  - B) profits.
  - C) its own welfare.
  - D) conflict with the executive and legislative branches of government.

Answer: C

*Ques Status: Previous Edition*

- 2) The theory of bureaucratic behavior when applied to the Fed helps to explain why the Fed
- A) is supportive of congressional attempts to limit the central bank's autonomy.
  - B) is so secretive about the conduct of future monetary policy.
  - C) sought less control over banks in the 1980s.
  - D) is willing to take on powerful groups that may threaten its autonomy.

Answer: B

*Ques Status: Previous Edition*

- 3) Compared to the Federal Reserve, the European Central Bank is less transparent because
- A) the European Central Bank doesn't publicly release its inflation rate target for the European Monetary Union while the Federal Reserve publicly releases its inflation rate target for the United States.
  - B) the Federal Reserve holds a press conference after a policy meeting while the European Central Bank makes no public statement after its policy meetings.
  - C) the Federal Reserve publicly releases the minutes 3 weeks after the meetings while the European Central bank waits 20 years to publicly release its minutes.
  - D) the European Central Bank does not publicly release its economic forecasts while the Federal Reserve immediately releases its economic forecasts to the public.

Answer: C

*Ques Status: New*

- 4) What is the theory of bureaucratic behavior and how can it be used to explain the behavior of the Federal Reserve?

Answer: The theory of bureaucratic behavior concludes that the main objective of any bureaucracy is to maximize its own welfare, which is related to power and prestige. This can explain why the Federal Reserve has defended its autonomy, avoids conflict with Congress and the president, and its push to gain more control over banks.

*Ques Status: New*

## 12.7 Should the Fed be Independent?

- 1) The case for Federal Reserve independence does not include the idea that
- A) political pressure would impart an inflationary bias to monetary policy.
  - B) a politically insulated Fed would be more concerned with long-run objectives and thus be a defender of a sound dollar and a stable price level.
  - C) policy is always performed better by an elite group such as the Fed.
  - D) a Federal Reserve under the control of Congress or the president might make the so-called political business cycle more pronounced.

Answer: C

*Ques Status: Previous Edition*

- 2) The political business cycle refers to the phenomenon that just before elections, politicians enact \_\_\_\_\_ policies. After the elections, the bad effects of these policies (for example, \_\_\_\_\_) have to be counteracted with \_\_\_\_\_ policies.
- A) expansionary; higher unemployment; contractionary
  - B) expansionary; a higher inflation rate; contractionary
  - C) contractionary; higher unemployment; expansionary
  - D) contractionary; a higher inflation rate; expansionary

Answer: B

*Ques Status: New*

- 3) The strongest argument for an independent Federal Reserve rests on the view that subjecting the Fed to more political pressures would impart
- A) an inflationary bias to monetary policy.
  - B) a deflationary bias to monetary policy.
  - C) a disinflationary bias to monetary policy.
  - D) a countercyclical bias to monetary policy.

Answer: A

*Ques Status: Previous Edition*

- 4) Critics of the current system of Fed independence contend that
- A) the current system is undemocratic.
  - B) voters have too much say about monetary policy.
  - C) the president has too much control over monetary policy on a day-to-day basis.
  - D) the Board of Governors is held responsible for policy missteps.

Answer: A

*Ques Status: Revised*

- 5) Recent research indicates that inflation performance (low inflation) has been found to be best in countries with
- A) the most independent central banks.
  - B) political control of monetary policy.
  - C) money financing of budget deficits.
  - D) a policy of always keeping interest rates low.

Answer: A

*Ques Status: Revised*

- 6) Make the case for and against an independent Federal Reserve.

Answer: Case for: 1. An independent Federal Reserve can shield the economy from the political business cycle, and it will be less likely to have an inflationary bias to monetary policy. 2. Control of the money supply is too important to leave to inexperienced politicians.

Case against: 1. It is undemocratic to have monetary policy be controlled by a small number of individuals that are not accountable. 2. In the past, an independent Fed has not used its freedom wisely. 3. Its independence may encourage it to pursue its own self-interest rather than the public's interest.

*Ques Status: New*