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NATIONAL UNIVERSITY OF IRELAND, GALWAY

AUTUMN EXAMINATIONS 2002

MONEY AND BANKING (EC 369)

Third Arts and Third Commerce

Professor H. Dixon
Professor M.P. Cuddy
Dr. S. Fountas

Time allowed: TWO hours
Please answer SIX questions from Part A and TWO questions from Part B.
Each question in Part A is worth 8 points and each question in Part B 26 points.

PART A

1. Explain the criteria for choosing operating and intermediate targets of monetary policy.

2. Explain the traditional view of regulation and the theory of regulatory capture. How would each theory explain the introduction of the system of US Federal Deposit Insurance in 1934 ?

3. Compare and contrast the quantity theory of money demand and the Cambridge equation of money demand.

4. State the square root formula of the Baumol-Tobin model of the transactions demand for money and derive the values of the income and interest rate elasticities of money demand.

5. What are the deficiencies of the simple model of multiple deposit creation ? What type of changes need to be made in the model to make it more realistic ?

6. Explain the arguments in favour and against the "too-big-to-fail policy".

7. Explain the rationale for the imposition of bank minimum capital requirements using the distinction between the private and social costs of bank failure.

8. "If depositors switch from checkable deposits to currency the monetary base will remain unchanged but the money supply will fall". True or false? Explain.

PART B

1. (a) Compare and contrast the following three theories of money demand: (i) the Keynesian liquidity preference theory, (ii) Tobin's speculative money demand theory and (iii) Friedman's modern version of the Quantity theory of money. (16 pts)

   (b) Discuss the assumptions of the Baumol-Tobin model of the transactions demand for money and derive the money demand function. (10 pts)

2. (a) Suppose that the banking system decides to increase the amount of excess reserves. What would be the net effect (if any) of this action on the monetary base ? Explain. (6 pts)

   (b) Suppose the required reserve ratio is 20% and the Fed makes an open-market purchase worth $5 billion. What would be the effect on the money supply according to the simple-deposit multiplier ? (6 pts)

   (c) Suppose that the Fed decides to pay interest on bank excess reserves. Would this policy have any effect on the money supply and the monetary base ? Would this policy enhance the Fed's control over the money supply ? Explain. (8 pts)

   (d) "If the total amount of Federal Funds increases, the money supply will increase while the monetary base will not be affected". True, false, or uncertain ? Explain. (6 pts)

3. (a) Explain all the factors that led to the U.S. banking crisis of the 1980s. (18 pts)

   (b) Discuss the objectives of the FDIC Improvement Act of 1991 and evaluate this piece of legislation. (8 pts)

4. (a) Explain the difference between asset and liability bank management. Explain three examples of liability management. (10 pts)

   (b) Explain the principles of bank loan management. (8 pts)

   (c) Explain the concept of equilibrium credit rationing. (8 pts)