DSST Money & Banking Practice Exam (Sample)

Study Guide

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Questions

1. Which of the following is included in the monetary base?

- **A. Savings accounts**
- **B. Stocks and bonds**
- **C. Notes and coins**
- **D. Real estate investments**

2. What are government payments such as unemployment benefits and food stamps classified as?

- **A. Public Transfer Payments**
- **B. Subsidies**
- **C. Tax credits**
- **D. Investment Grants**

3. Why is the monetary base critical for economic stability?

- **A. It controls stock market prices**
- **B. It ensures a stable supply of high-risk loans**
- **C. It facilitates efficient monetary policy implementation**
- **D. It influences foreign exchange rates directly**

4. What accord aimed to eliminate interest rate pegging to stabilize interest rates?

- **A. Fed-Treasury Agreement**
- **B. Monetary Policy Accord**
- **C. Federal Reserve-Treasury Accord (of 1951)**
- **D. Interest Rate Stabilization Act**

5. What characteristic distinguishes near money from regular money?

- **A. It can be easily converted into cash**
- **B. It is always held in foreign currency**
- **C. It cannot be spent directly**
- **D. It has a fixed value over time**

6. **According to Irving Fisher, which factor affects the velocity of money?**
   A. The number of pay periods per year
   B. The overall demand for goods
   C. The level of consumer confidence
   D. The stability of the banking system

7. **If adding another worker to a production line barely increases productivity, what is that an example of?**
   A. Increasing returns to scale
   B. Marginal product
   C. Diminishing returns
   D. Economies of scale

8. **Which legislation allowed financial institutions to sell various competing products, like insurance and stocks?**
   A. Banking Modernization Act
   B. Financial Services Modernization Act of 1999
   C. Consumer Banking Act
   D. Investment Services Reform Act

9. **What type of market is defined by an expectation that stock prices will increase in the future?**
   A. Bear Market
   B. Equity Market
   C. Futures Market
   D. Bull Market

10. **Which equation represents operating profit?**
   A. Gross Sales - Net Sales
   B. Gross Margin - Selling and Administrative Expenses
   C. Net Sales - Cost of Goods Sold
   D. Total Revenue - Total Expenses

Answers

1. C
2. A
3. C
4. C
5. A
6. A
7. C
8. B
9. D
10. B

Explanations

1. Which of the following is included in the monetary base?

A. Savings accounts

B. Stocks and bonds

C. Notes and coins

D. Real estate investments

The monetary base, also referred to as the money supply or high-powered money, includes the total amount of a country's currency in circulation and the reserves held by the central bank. Specifically, this consists of physical currency such as notes and coins that are in the hands of the public, as well as the reserves that commercial banks hold at the central bank. Physical notes and coins, being the most direct representation of money, are essential components of the monetary base. They represent the liquidity available in the economy for consumers and businesses to conduct transactions. This is why notes and coins are included in the definition of the monetary base. In contrast, savings accounts, stocks and bonds, and real estate investments are not considered part of the monetary base. Savings accounts represent deposits held by individuals in banks, which contribute to broader measures of money supply, but they do not constitute physical currency. Stocks and bonds are financial assets representing ownership or debt and do not have the same liquidity as cash. Real estate investments are also not a form of currency; instead, they are tangible assets that can appreciate or depreciate in value but do not directly contribute to the monetary base. Thus, the correct choice emphasizes the most fundamental elements that compose the monetary base, which are the notes and

2. What are government payments such as unemployment benefits and food stamps classified as?

A. Public Transfer Payments

B. Subsidies

C. Tax credits

D. Investment Grants

Government payments such as unemployment benefits and food stamps are classified as public transfer payments because they involve the redistribution of income from one group to another without any direct exchange of goods or services. Public transfer payments are designed to help individuals and families who may be facing financial difficulties, thereby providing them with essential support. These payments are funded by tax revenues and are intended to assist specific populations within society, particularly those in need. Unemployment benefits provide temporary financial assistance to those who have lost their jobs, while food stamps help low-income individuals and families afford adequate nutrition. This classification emphasizes their role in social welfare and economic stability by ensuring that certain baseline living standards are met for all citizens. Other options like subsidies, tax credits, and investment grants refer to different financial mechanisms that do not fit the nature of direct governmental support provided to individuals as described in the question. Subsidies typically support businesses or industries, tax credits reduce tax liability but do not provide direct cash payments, and investment grants are usually aimed at funding specific projects rather than providing ongoing personal support.

3. Why is the monetary base critical for economic stability?

A. It controls stock market prices

B. It ensures a stable supply of high-risk loans

C. It facilitates efficient monetary policy implementation

D. It influences foreign exchange rates directly

The monetary base is critical for economic stability primarily because it facilitates efficient monetary policy implementation. The monetary base, which includes the total amount of a country's currency in circulation plus the reserves held by banks at the central bank, serves as a fundamental tool for the central bank in managing the economy's money supply and overall liquidity. When the central bank adjusts the monetary base, it influences interest rates, which affects borrowing and spending by consumers and businesses. This, in turn, impacts inflation rates and economic growth. An effective and responsive monetary policy can help stabilize the economy by mitigating fluctuations and ensuring that the financial system operates smoothly. The other options, while they may relate to aspects of the economy, do not capture the primary role of the monetary base. Controlling stock market prices is more about investor sentiment and market conditions, rather than a direct function of the monetary base. A stable supply of high-risk loans is influenced by various factors, including credit risk and lending guidelines, rather than just the monetary base. Lastly, while the monetary base can have an indirect effect on foreign exchange rates, its primary purpose is not to influence these rates directly, but rather to serve as a foundation for monetary policy actions.

4. What accord aimed to eliminate interest rate pegging to stabilize interest rates?

A. Fed-Treasury Agreement

B. Monetary Policy Accord

C. Federal Reserve-Treasury Accord (of 1951)

D. Interest Rate Stabilization Act

The Federal Reserve-Treasury Accord of 1951 is recognized for its pivotal role in reshaping the relationship between the Federal Reserve and the U.S. Treasury, particularly concerning interest rate policy. Prior to this accord, during World War II, the Federal Reserve maintained a policy of keeping interest rates low to facilitate government borrowing, which led to an environment of interest rate pegging. This created distortions in the economy and limited the Federal Reserve's ability to conduct independent monetary policy. The 1951 accord marked a significant shift by allowing the Federal Reserve to pursue monetary policies aimed at controlling inflation and stabilizing the economy without being constrained by the need to maintain low-interest rates for government debt. This agreement effectively ended the practice of pegging interest rates and enabled the Federal Reserve to focus on its broader economic objectives, including achieving stable price levels. The significance of this accord is reflected in its long-term impact on the conduct of U.S. monetary policy, as it laid the groundwork for more flexible interest rate policies that respond to changing economic conditions. By transitioning away from interest rate pegging, the Federal Reserve gained the autonomy needed to enact policies that could better address inflationary pressures and promote stable economic growth.

5. What characteristic distinguishes near money from regular money?

A. It can be easily converted into cash

B. It is always held in foreign currency

C. It cannot be spent directly

D. It has a fixed value over time

Near money refers to financial assets that can easily be converted into cash but are not a medium of exchange themselves. This includes instruments like savings accounts, certificates of deposit, and Treasury bills. The defining characteristic of near money is its liquidity—in that it can be quickly and conveniently transformed into cash without a significant loss of value. The correct understanding centers around the ease of conversion. While near money can be converted into cash smoothly, it differs from regular money, which is directly used for transactions. This aspect makes near money a useful instrument for holding and managing wealth while retaining the ability to access cash when necessary. The other choices present concepts that do not accurately capture the essence of near money. For instance, while foreign currency can sometimes be considered near money, it is not a defining characteristic. Some entities might hold near money in their domestic currency as well. The idea that near money cannot be spent directly is correct, as it emphasizes that while it is not used for day-to-day transactions like cash, it can still be converted into cash for spending purposes. Lastly, the suggestion that near money has a fixed value over time is misleading; values of savings instruments can fluctuate due to interest rates and economic conditions, in contrast to cash, which has a more stable purchasing

6. According to Irving Fisher, which factor affects the velocity of money?

A. The number of pay periods per year

B. The overall demand for goods

C. The level of consumer confidence

D. The stability of the banking system

The correct answer is the number of pay periods per year, as this directly influences how frequently money circulates within the economy. Irving Fisher's equation of exchange focuses on the relationship between money supply, velocity, price levels, and output (MV=PQ). When individuals receive their pay more frequently, they are likely to spend that money sooner, thereby increasing the velocity of money—the rate at which money changes hands in transactions for goods and services. For example, if individuals receive weekly paychecks instead of monthly ones, they would have the opportunity to spend their earnings more often within that period, which increases the velocity of money. This relationship highlights how the structure of income distribution and payment frequency can significantly impact economic activity. While factors like overall demand for goods, level of consumer confidence, and banking system stability may influence economic conditions, they do not directly affect how quickly money changes hands in the way that the frequency of pay periods does.

7. If adding another worker to a production line barely increases productivity, what is that an example of?

A. Increasing returns to scale

B. Marginal product

C. Diminishing returns

D. Economies of scale

The scenario described illustrates the principle of diminishing returns. This concept occurs when the addition of a variable input, such as labor, results in progressively smaller increases in output. When adding another worker to a production line results in only a slight boost in productivity, it highlights that the factors of production are not being utilized efficiently. Initially, as more workers are added, productivity may increase significantly, but beyond a certain point, the ability of additional workers to contribute effectively diminishes. This typically happens in a fixed production environment where other resources, such as machinery or space, remain unchanged. Thus, the correct answer emphasizes that the marginal gains from adding more labor are decreasing, illustrating the key concept of diminishing returns in production economics.

8. Which legislation allowed financial institutions to sell various competing products, like insurance and stocks?

A. Banking Modernization Act

B. Financial Services Modernization Act of 1999

C. Consumer Banking Act

D. Investment Services Reform Act

The Financial Services Modernization Act of 1999 is recognized for removing the barriers that previously separated different types of financial institutions, such as banks, securities firms, and insurance companies. This pivotal legislation effectively allowed these institutions to offer a diverse array of financial products, including insurance, stocks, and other investment vehicles, under one roof. By allowing banks to engage in investment activities and insurance, it fostered increased competition and provided consumers with more choices and convenience when managing their financial needs. The act aimed to modernize the financial services sector, ensuring that institutions could adapt to changing market conditions and consumer demands. This transformation led to the creation of large financial service conglomerates that could serve clients with a comprehensive suite of products, reinforcing the interconnected nature of the financial services industry. The significant change brought about by this legislation was a clear move towards integrating and diversifying financial services for consumers.

9. What type of market is defined by an expectation that stock prices will increase in the future?

A. Bear Market

B. Equity Market

C. Futures Market

D. Bull Market

A market characterized by the expectation that stock prices will increase in the future is referred to as a bull market. In this environment, investor confidence is high, leading to increased buying activity. As more participants enter the market anticipating higher prices, demand for stocks rises, which typically drives prices up even further. The notion of a bull market is pivotal because it reflects a period when the overall sentiment is optimistic, often fueled by strong economic factors or positive developments in specific sectors. It's a time when investors are more likely to take risks, as the prospect of gains outweighs concerns about potential losses. Understanding this concept is important because bull markets can influence investment strategies and overall market dynamics, shaping how individuals and institutions approach their asset allocation and portfolio management.

10. Which equation represents operating profit?

A. Gross Sales - Net Sales

B. Gross Margin - Selling and Administrative Expenses

C. Net Sales - Cost of Goods Sold

D. Total Revenue - Total Expenses

Operating profit is a key measure of a company's profitability from its core business operations, excluding any income derived from non-operating activities such as investments or sales of assets. It reflects the efficiency of a company in managing its operational costs. The correct expression for operating profit is derived from taking the gross margin and subtracting selling and administrative expenses. Gross margin refers to the revenue remaining after deducting the cost of goods sold, which gives a clear picture of how much money is generated from sales before accounting for overhead and administrative costs. By then subtracting selling and administrative expenses from this gross margin, you arrive at the operating profit, which indicates how well a company is performing in its primary business operations. This direct approach to calculating operating profit highlights the operational effectiveness of the business, making it easier to assess company performance without the influence of financing costs or investment income. It prepares investors and management to make informed decisions regarding the company's profitable core operations.