ECON UN3265: Money and Banking

Summer 2026 — Practice Quiz

Chapter 8 — Practice Quiz

How to use this quiz. These multiple-choice questions are based on the Chapter 8 practice questions and applied problems on financial institutions and structure. The answer key is on the last page.

Questions

1. Which statement best summarizes the main sources of external funding in the United States, Germany, Japan, and Canada?

- **A)** Stocks are the largest source of external funds in all four countries, while bank loans are the smallest.
- **B)** External funding generally relies heavily on loans from financial intermediaries, while stocks are relatively small; the United States and Canada rely more on securities markets than Germany and Japan.
- **C)** Bonds are the largest source in Japan and Germany, while stocks are the largest source in the United States and Canada.
- **D)** All four countries have essentially identical patterns of external finance, with no meaningful differences across sources.

2. How can economies of scale help explain the existence of financial intermediaries?

- **A)** They allow small savers to avoid all risk by holding only one financial asset.
- **B)** They let intermediaries spread information, transaction, and monitoring costs over many customers and many loans, making finance cheaper.
- **C)** They eliminate the need for diversification because large institutions never default.
- **D)** They make direct finance legally impossible for households and firms.

3. Why are financial intermediaries willing to collect information when individual investors may be unwilling to do so?

- **A)** Because they can keep the benefits of the information private by making loans themselves, reducing the free-rider problem.
- **B)** Because the government pays intermediaries for every borrower they investigate.
- **C)** Because individual investors have better information than intermediaries but are legally barred from using it.
- **D)** Because information collection is costless for banks.

4. Why would Alessandro prefer buying a certificate of deposit instead of directly lending to the next student-loan applicant at a rate between the bank's deposit rate and loan rate?

- **A)** Because the bank can screen, monitor, diversify, and enforce loans better than he can, reducing asymmetric information and transaction costs.
- **B)** Because direct lending would always be illegal in Italy regardless of the contract.
- **C)** Because a certificate of deposit has a higher interest rate than every possible student loan.
- **D)** Because student loans have no default risk and therefore no need for monitoring.

5. Kabir is told that he must leave the house as collateral to receive a mortgage. Which asymmetric information problem is the bank trying to solve?

- **A)** Only the free-rider problem, because collateral prevents other banks from copying information.

- **B)** Moral hazard, because collateral gives the borrower an incentive to repay and avoid actions that increase default risk.
- **C)** Inflation risk, because collateral fixes the real value of the loan.
- **D)** The double coincidence of wants, because collateral is a medium of exchange.

6. Mario can lend either to Gianluigi, who put all his life savings into a restaurant, or to Rebecca, who has a regular job and has not done so. If everything else is the same, to whom should he be more willing to lend?

- **A)** Gianluigi, because putting his own wealth into the restaurant gives him more to lose and reduces moral hazard.
- **B)** Rebecca, because having no personal investment always makes a borrower safer.
- **C)** Neither, because collateral and borrower incentives are irrelevant for lending.
- **D)** Gianluigi only if he promises not to repay the loan.

7. What steps can government take to reduce asymmetric information problems and help the financial system work more efficiently?

- **A)** Eliminate accounting rules so firms can disclose information more flexibly.
- **B)** Improve disclosure standards, accounting rules, legal enforcement, supervision, and regulation that limit fraud and excessive risk taking.
- **C)** Ban all financial intermediaries and require every saver to lend directly.
- **D)** Guarantee that no investor ever faces losses in any market.

8. How can asymmetric information problems lead to a bank panic?

- **A)** Depositors may not know which banks are sound, so fear about some banks can cause runs on many banks, including healthy ones.
- **B)** Banks become safer when depositors lack information, so panics become impossible.
- **C)** A panic occurs only when every bank has already failed.
- **D)** Asymmetric information affects stock markets but never banks.

9. How does the free-rider problem aggravate adverse selection and moral hazard in financial markets?

- **A)** When investors can copy information discovered by others, fewer investors pay to gather or monitor information, so bad risks and risky behavior are harder to control.
- **B)** Free riding makes information collection more profitable, so adverse selection disappears.
- **C)** Free riding applies only to public transportation, not financial markets.
- **D)** Free riding eliminates moral hazard because borrowers are monitored by everyone.

10. In a bond market with no information that helps buyers distinguish between bonds, which issuers have an incentive to disclose information about their companies?

- **A)** High-quality issuers, because disclosure helps separate them from low-quality issuers and allows them to borrow at lower interest rates.
- **B)** Low-quality issuers, because disclosure always hides bad information.
- **C)** No issuers, because disclosure can never affect bond prices.
- **D)** Only issuers that have already defaulted.

11. How can asymmetric information provide a rationale for government regulation of financial markets?

- **A)** Regulation can require disclosure, set standards, and supervise institutions to reduce adverse selection, moral hazard, fraud, and instability.
- **B)** Regulation is justified only if all investors already have perfect information.
- **C)** Asymmetric information implies that markets should never be regulated.
- **D)** Regulation solves asymmetric information by banning all loans.

12. The more collateral there is backing a loan, the less the lender has to worry about adverse selection. Is this statement true, false, or uncertain?

- **A)** True, because collateral reduces expected losses and can make lending to riskier borrowers less dangerous.
- **B)** False, because collateral increases default risk by giving borrowers nothing to lose.
- **C)** Uncertain, because collateral matters only for inflation, not borrower quality.
- **D)** False, because collateral is useful only after a borrower has fully repaid.

13. Why might deposit insurance create more problems than solutions in a developing country's financial system?

- **A)** If supervision and regulation are weak, deposit insurance can increase moral hazard by encouraging banks and depositors to tolerate excessive risk taking.
- **B)** Deposit insurance always eliminates moral hazard because banks become more careful.
- **C)** Deposit insurance makes bank runs more likely by guaranteeing no depositor will be paid.
- **D)** It creates problems only because it reduces the money supply mechanically.

14. Why might Albanian banks require collateral up to 150% of a mortgage loan in a weak legal and financial system, and what are the consequences?

- **A)** Weak enforcement makes recovery of collateral costly and uncertain, so banks demand more protection; this restricts credit and slows investment and growth.
- **B)** Strong enforcement makes collateral unnecessary, so banks demand extra collateral only to lower profits.
- **C)** High collateral requirements increase lending to poor households and always speed economic growth.
- **D)** Collateral has no connection to legal systems or economic growth.

15. A used car's value is symmetrically distributed between \$20,000 and \$24,000, and you believe the dealer knows no more than you do. How much are you willing to pay?

- **A)** \$20,000, because buyers should always offer the lowest possible value.
- **B)** \$22,000, because with symmetric information the expected value is the midpoint of the distribution.
- **C)** \$24,000, because buyers should always offer the highest possible value.
- **D)** \$44,000, because expected value adds the minimum and maximum values.

16. Now suppose the dealer knows more about the car than you do. How much are you willing to pay, and how could this asymmetric information problem be reduced in a competitive market?

- **A)** About \$24,000, because asymmetric information always raises the price; it can be reduced by banning warranties.
- **B)** No more than the lowest likely value, about \$20,000, because higher offers attract worse-quality cars; warranties, certification, inspections, and reputation can reduce the problem.
- **C)** Exactly \$22,000, because asymmetric information never changes willingness to pay.
- **D)** Nothing at all, because no used car can ever be traded under asymmetric information.

Answer Key

1. B 2. B 3. A 4. A 5. B 6. A 7. B 8. A 9. A 10. A 11. A 12. A 13. A 14. A 15. B 16. B