A-LEVEL ECONOMICS • EXERCISE SHEET

9.4 Money and banking

Name: ____________ Class: ________ Date: __________ **Total: 25 marks**

KEY WORDS liquidity 流动性 • interest rate 利率 • liquidity preference 流动性偏好 • money supply 货币供给 • moral hazard 道德风险

Objective

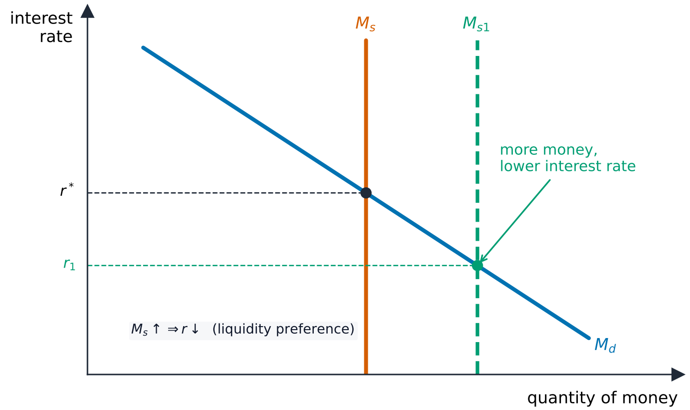
Build the skills to answer exam questions on **money and banking** 货币与银行 — the **functions of money** 货币职能, the role of the **central and commercial banks** 中央与商业银行, **liquidity preference** 流动性偏好, and **moral hazard** 道德风险.

You must be able to:

- state the four functions of money
- explain the roles of central and commercial banks
- analyse how the interest rate is set and the risk of moral hazard

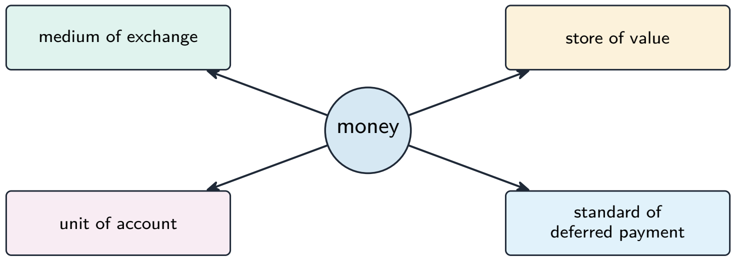
1 Worked examples

■ Money and the money market



A larger money supply tends to lower the interest rate

- **Four functions of money: medium of exchange** 交换媒介, **store of value** 价值储藏, **unit of account** 记账单位, **standard of deferred payment** 延期支付标准.



The four functions of money, which a definition question expects you to name

- **Central bank** 中央银行: issues notes, runs monetary policy, **lender of last resort** 最后贷款人. **Commercial banks** create money by lending.
- **Liquidity preference** 流动性偏好: the demand to hold money → with money supply, sets the **interest rate** 利率.
- **Moral hazard** 道德风险: banks take bigger risks if they expect a bailout.

Answer shapes: AO1 + AO2 + AO3 (analysis) + AO4 (a supported judgement *in context*).

2 Practice

2.1 State the four functions of money. [2]

2.2 Define the term *liquidity preference*. [2]

2.3 Define the term *moral hazard*. [2]

3 Exam-style questions

3.1 Which is **not** a function of money? [1]

- **A** a medium of exchange
- **B** a store of value
- **C** a factor of production
- **D** a unit of account

3.2 Explain how an increase in the money supply affects the interest rate. [6]

3.3 Discuss whether moral hazard means governments should never rescue failing banks. [12]

Solutions

Economics answers are marked by **level of response** against the assessment objectives: award **AO1** knowledge, **AO2** application, **AO3** analysis and **AO4** evaluation.

2.1 medium of exchange; store of value; unit of account; standard of deferred payment (2 for all four; 1 for two or three).

2.2 the demand to hold money rather than other assets, because of its liquidity (the ability to spend it at once) (2 for a clear definition; 1 for a partial idea).

2.3 the risk that a party takes bigger risks because it expects to be protected from the consequences (e.g. a bank expecting a bailout) (2 for a clear definition; 1 for a partial idea).

3.1 C. A factor of production is not a function of money.

3.2 *[6]* AO1 1 + AO3 up to 5 — with money demand (liquidity preference) downward-sloping, a larger money supply means there is more money than people wish to hold at the current rate → they lend the surplus, bidding the interest rate down → the rate falls until demand for money equals the new, larger supply.

3.3 *[12]* AO1/AO2/AO3 up to 8 + AO4 up to 4. **For not rescuing:** bailouts create moral hazard — banks lend recklessly expecting rescue, raising future risk. **Against:** letting a major bank fail can trigger a wider financial crisis, freezing lending and harming the whole economy. Judgement: a blanket "never rescue" rule is risky; the better answer is to rescue only where failure threatens the system, while adding regulation to limit moral hazard — it depends on the bank's systemic importance.