AQA A-LEVEL ECONOMICS · 7136

ECONOMICS



EXAM QUESTION PACK

3.2.4.4 THE REGULATION OF THE FINANCIAL SYSTEM

SCORE	PERCENTAGE
/43	%

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1. Systemic risk is most likely to occur in financial systems when

A investment banks have low capital-output ratios. ⬭

B most banks carry out both commercial and investment banking activities. ⬭

C the central bank acts as lender of last resort to financial institutions. ⬭

D the commercial banks have high liquidity ratios. ⬭

[1 mark]

2. The table below shows different combinations of changes in a commercial bank's liquidity and capital ratios. All other things being equal, which one of the following combinations, **A**, **B**, **C** or **D**, is most likely to improve the bank's financial stability?

	Liquidity ratio	Capital ratio	
A	Increase	Decrease	⬭
B	Increase	Increase	⬭
C	Decrease	Increase	⬭
D	Decrease	Decrease	⬭

[1 mark]

3. Moral hazard results when individuals and organisations make investment decisions

A based on asymmetric information. ⬭

B because they expect to make a large profit. ⬭

C based on the returns made on previous investments. ⬭

D knowing that others will bear the loss if things go wrong. ⬭

[1 mark]

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4. Since 1998, the Bank of England has had responsibility for the operation of monetary policy and maintaining price stability. In response to the financial crisis of 2007–08, the Financial Services Act 2012 gave the Bank of England overall responsibility for financial stability. This was designed to reduce systemic risk and the impact on the real economy of problems that arise in financial markets.

Evaluate the view that strict rules and regulations on financial markets are essential to help create a more stable economy.

[25 marks]

5. Commercial banks provide financial services for both individuals and businesses. In 2007–08, the financial crisis led many to argue for tighter regulation of the banks to prevent problems in financial markets affecting the real economy. However, financial markets are not the only source of cyclical instability. Governments can use a variety of policies to try to create a more stable economy.

Explain the role of commercial banks in the economy.

[15 marks]

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