

Quiz #2
The Economics of Emerging Financial Markets

1. List and explain some benefits and costs of high reserve requirements on banks.

Benefits:

- *Provides liquidity for withdrawals by depositors*
- *Central bank and government can acquire risk-free loans*
- *Can be used to sterilize large capital inflows*

Costs:

- *Imposes a tax on banks*
- *Discourages the government from raising funds through more transparent sources*

2. Why would governments restrict the entry and operations of foreign banks?

To prevent competition, which would drive down the profits of domestic banks. The government may have an interest in using the domestic banking system to finance government projects or to obtain cheap funds for political uses. Increasing competition would decrease their ability to extract rents from the domestic banking system.

3. Name two benefits of financial markets/assets/intermediaries to economic well being.

- *Increases savings, investment and therefore long-run economic growth*
- *Allows consumption smoothing*
- *Allows risk shifting*