***Fundamentals of Multinational Finance, 6e* (Moffett et al.)**
Chapter 2 The International Monetary System

2.1 History of the International Monetary System

1) Under the gold standard of currency exchange that existed from 1879 to 1914, an ounce of gold cost $20.67 in U.S. dollars and £4.2474 in British pounds. Therefore, the exchange rate of pounds per dollar under this fixed exchange regime was:
A) £4.8665/$.
B) £0.2055/$.
C) always changing because the price of gold was always changing.
D) unknown because there is not enough information to answer this question.
Answer: B
Diff: 2
L.O.: 2.1 History of the International Monetary System
Skill: Analytical
AACSB: Analytical thinking

2) World War I caused the suspension of the gold standard for fixed international exchange rates because the war:
A) cost too much money.
B) interrupted the free movement of gold.
C) lasted too long.
D) used gold as the main ingredient in armament plating.
Answer: B
Diff: 1
L.O.: 2.1 History of the International Monetary System
Skill: Recognition
AACSB: Application of knowledge

3) The post WWII international monetary agreement that was developed in 1944 is known as the:
A) United Nations.
B) League of Nations.
C) Yalta Agreement.
D) Bretton Woods Agreement.
Answer: D
Diff: 1
L.O.: 2.1 History of the International Monetary System
Skill: Recognition
AACSB: Application of knowledge

4) Another name for the International Bank for Reconstruction and Development is:
A) the Recon Bank.
B) the European Monetary System.
C) the Marshall Plan.
D) the World Bank.
Answer: D
Diff: 1
L.O.: 2.1 History of the International Monetary System
Skill: Recognition
AACSB: Application of knowledge

5) The International Monetary Fund (IMF):
A) in recent years has provided large loans to Russia, South Korea, and Brazil.
B) was created as a result of the Bretton Woods Agreement.
C) aids countries with balance of payment and exchange rate problems.
D) is all of the above.
Answer: D
Diff: 1
L.O.: 2.1 History of the International Monetary System
Skill: Recognition
AACSB: Application of knowledge

6) One of the innovations introduced by Bretton Woods was the creation of the Special Drawing Right or SDR. The SDR is an international reserve asset created by the:
A) U.S. Department of the Treasury.
B) International Bank of Reconstruction and Development (IBRD).
C) World Bank (WB).
D) International Monetary Fund (IMF).
Answer: D
Diff: 1
L.O.: 2.1 History of the International Monetary System
Skill: Recognition
AACSB: Application of knowledge

7) Which of the following led to the eventual demise of the fixed currency exchange rate regime worked out at Bretton Woods?
A) widely divergent national monetary and fiscal policies among member nations
B) differential rates of inflation across member nations
C) several unexpected economic shocks to member nations
D) all of the above
Answer: D
Diff: 2
L.O.: 2.1 History of the International Monetary System
Skill: Recognition
AACSB: Application of knowledge

8) Which of the following statements is NOT true?
A) The Gold Standard Era was characterized by growing openness in trade, but limited capital mobility.
B) The time period between world wars 1 and 2 (the inter war years) witnessed significant reductions in trade barriers and a rapid acceleration in international trade.
C) The Bretton Woods Era (post WWII) realized the increasing benefits of open economies. Furthermore, trade was increasingly dominated by capital.
D) Since March 1973, exchange rates have become much more volatile and less predictable than previous periods.
Answer: B
Diff: 2
L.O.: 2.1 History of the International Monetary System
Skill: Recognition
AACSB: Application of knowledge

9) A review of the evolution of the Global Monetary System shows that capital flows dominate trade in which of the following eras EXCEPT:
A) Classical Gold Standard.
B) Fixed Exchange Rates, 1945-1973.
C) The Floating Era, 1973-1997.
D) The Emerging Era, 1997-Present.
Answer: A
Diff: 2
L.O.: 2.1 History of the International Monetary System
Skill: Recognition
AACSB: Application of knowledge

10) Since 2009 the IMF's exchange rate regime classification system uses a "de facto classification" methodology. Under this system, a country that has given up their own sovereignty over monetary
policy is considered to have:
A) a residual agreement.
B) hard pegs.
C) soft pegs.
D) floating arrangements.
Answer: B
Diff: 2
L.O.: 2.1 History of the International Monetary System
Skill: Recognition
AACSB: Application of knowledge

11) Since 2009 the IMF's exchange rate regime classification system uses a "de facto classification" methodology. Under this system, countries with "fixed exchange rates" are considered to have:
A) a residual agreement.
B) soft pegs.
C) hard pegs.
D) floating arrangements.
Answer: B
Diff: 2
L.O.: 2.1 History of the International Monetary System
Skill: Recognition
AACSB: Application of knowledge

12) A small economy country whose GDP is heavily dependent on trade with the United States could use a(n) ________ exchange rate regime to minimize the risk to their economy that could arise due to unfavorable changes in the exchange rate.
A) pegged exchange rate with the United States
B) pegged exchange rate with the Euro
C) independent floating
D) managed float
Answer: A
Diff: 1
L.O.: 2.1 History of the International Monetary System
Skill: Conceptual
AACSB: Application of knowledge

13) Since 2009 the IMF's exchange rate regime classification system uses a "de facto classification" methodology. Under this system, currencies that are predominantly market-driven are considered to be:
A) soft pegs.
B) hard pegs.
C) floating arrangements.
D) a residual agreement.
Answer: C
Diff: 1
L.O.: 2.1 History of the International Monetary System
Skill: Recognition
AACSB: Application of knowledge

14) Among IMF member countries since 2010 the dominating exchange rate regime has been:
A) hard peg.
B) soft peg.
C) floating arrangements.
D) residual agreement.
Answer: B
Diff: 1
L.O.: 2.1 History of the International Monetary System
Skill: Recognition
AACSB: Application of knowledge

15) Under the terms of Bretton Woods, countries tried to maintain the value of their currencies to within 1% of a hybrid security made up of the U.S. dollar, British pound, and Japanese yen.
Answer: FALSE
Explanation: Under the terms of Bretton Woods, countries tried to maintain the value of their currencies to within 1% of the U.S. dollar.
Diff: 2
L.O.: 2.1 History of the International Monetary System
Skill: Recognition
AACSB: Application of knowledge

16) Members of the International Monetary Fund may settle transactions among themselves by transferring Special Drawing Rights (SDRs).
Answer: TRUE
Diff: 1
L.O.: 2.1 History of the International Monetary System
Skill: Recognition
AACSB: Application of knowledge

17) Today, the United States has been ejected from the International Monetary Fund for refusal to pay annual dues.
Answer: FALSE
Explanation: The USA has not been ejected from the IMF.
Diff: 1
L.O.: 2.1 History of the International Monetary System
Skill: Recognition
AACSB: Application of knowledge

18) From the time of its creation through July 2012, the euro peaked versus the USD in April 2008 at around $1.60/€.
Answer: TRUE
Diff: 2
L.O.: 2.1 History of the International Monetary System
Skill: Recognition
AACSB: Application of knowledge

19) Since March 1973, when exchange rates become more volatile and less predictable than during the "fixed" exchange rate period, the nominal exchange rate index of the U.S. dollar peaked in 2011.
Answer: FALSE
Diff: 2
L.O.: 2.1 History of the International Monetary System
Skill: Recognition
AACSB: Application of knowledge

20) The euro is an example of a rigidly fixed system, acting as a single currency for its member countries. However, the euro itself is an independently floating currency against all other currencies.
Answer: TRUE
Diff: 1
L.O.: 2.1 History of the International Monetary System
Skill: Recognition
AACSB: Application of knowledge

21) Although the contemporary international monetary system is typically referred to as a "floating regime," it is clearly not the case for the majority of the world's nations.
Answer: TRUE
Diff: 1
L.O.: 2.1 History of the International Monetary System
Skill: Recognition
AACSB: Application of knowledge

22) The IMF's methodology for classifying exchange rate regimes today is based on the official policy statement of the respective governments, *de jure* classification.
Answer: FALSE
Explanation: It is based on actual observed behavior, *de facto* results and not on the policy statements of the respective governments, *de jure* classification.
Diff: 1
L.O.: 2.1 History of the International Monetary System
Skill: Recognition
AACSB: Application of knowledge

23) Most Western nations were on the gold standard for currency exchange rates from 1876 until 1914. Today we have several different exchange rate regimes in use, but most larger economy nations have freely floating exchange rates today and are not obligated to convert their currency into a predetermined amount of gold on demand. Currently several parties still call for the "good old days" and a return to the gold standard. Develop an argument as to why this is a good idea.
Answer: The gold standard forces a nation to maintain sufficient reserves of gold to back its currency's value. This helps control inflation, as a country cannot print additional money without sufficient gold to back it up. The gold standard eases international transactions as there is little uncertainly about exchange rates for trade with foreign countries.
Diff: 3
L.O.: 2.1 History of the International Monetary System
Skill: Conceptual
AACSB: Application of knowledge

24) The mobility of international capital flows is causing emerging market nations to choose between a free-floating currency exchange regime and a currency board (or taken to the limit, dollarization). Describe how each of the regimes would work and identify at least two likely economic results for each regime.
Answer: With free float the exchange rate is market determined and beyond the control of the country's central bank or government. The economic results are likely to be an independent monetary policy, free movement of capital, but less stability in the exchange rate. Such instability may be more than an emerging market country's small financial market can bear. A currency board on the other hand is an implied legislative commitment to fix the foreign exchange rate with a specific currency, generally the country's major trading partner. Dollarization is taking this policy to the extreme whereby the emerging market nation forgoes its currency for that of its major trading partner. An example of Dollarization is Panama using U.S. dollars as the official Panamanian currency. With such a regime, independent monetary policy is lost and political influence on monetary policy is eliminated. However, the benefits accruing to countries as a result of the ability to print its own money, seignorage, is lost.
Diff: 2
L.O.: 2.1 History of the International Monetary System
Skill: Conceptual
AACSB: Application of knowledge

2.2 Fixed Versus Flexible Exchange Rates

1) Based on the premise that, other things equal, countries would prefer a fixed exchange rate, which of the following statements is NOT true?
A) Fixed rates provide stability in international prices for the conduct of trade.
B) Fixed exchange rate regimes necessitate that central banks maintain large quantities of international reserves for use in the occasional defense of the fixed rate.
C) Fixed rates are inherently inflationary in that they require the country to follow loose monetary and fiscal policies.
D) Stable prices aid in the growth of international trade and lessen exchange rate risks for businesses.
Answer: C
Diff: 2
L.O.: 2.2 Fixed Versus Flexible Exchange Rates
Skill: Conceptual
AACSB: Application of knowledge

2) According to the terminology associated with changes in currency values, which of the following choices is the case when a currency's value relative to other currencies is changed by a government?
A) depreciation and revaluation
B) devaluation and appreciation
C) devaluation and revaluation
D) depreciation and appreciation
Answer: C
Diff: 2
L.O.: 2.2 Fixed Versus Flexible Exchange Rates
Skill: Recognition
AACSB: Application of knowledge

3) Based on the premise that, other things equal, countries would prefer a fixed exchange rate: Variable rates provide stability in international prices for the conduct of trade.
Answer: FALSE
Explanation: Based on the premise that, other things equal, countries would prefer a fixed exchange rate: Variable rates provide instability in international prices for the conduct of trade.
Diff: 1
L.O.: 2.2 Fixed Versus Flexible Exchange Rates
Skill: Conceptual
AACSB: Application of knowledge

4) If exchange rates were fixed, investors and traders would be relatively certain about the current and near future exchange value of each currency.
Answer: TRUE
Diff: 1
L.O.: 2.2 Fixed Versus Flexible Exchange Rates
Skill: Conceptual
AACSB: Application of knowledge

5) According to the terminology associated with changes in currency values, depreciation is a case when a currency's value relative to other currencies is changed by a government.
Answer: FALSE
Explanation: When a currency's value is changed in the open currency market — not directly by government - it is called a *depreciation* (with a fall in value) or *appreciation* (with an increase in value).
Diff: 1
L.O.: 2.2 Fixed Versus Flexible Exchange Rates
Skill: Conceptual
AACSB: Application of knowledge

6) By and large, high capital mobility is forcing emerging market nations to choose between the two extremes of a free floating exchange rate or a hard peg regime.
Answer: TRUE
Diff: 1
L.O.: 2.2 Fixed Versus Flexible Exchange Rates
Skill: Conceptual
AACSB: Application of knowledge

7) List and explain the three attributes (often referred as the impossible trinity) an ideal currency would possess if existed in today's world.
Answer: If the ideal currency existed in today's world, it would possess the following three attributes, often referred to as the *impossible trinity*: 1) Exchange rate stability: the value of the currency is fixed (and relatively certain) in relationship to other major currencies. 2) Full financial integration: complete freedom of monetary flows would be allowed. 3) Monetary independence: domestic monetary and interest rate policies would be set by each individual country to pursue desired national economic policies. These qualities are termed the *impossible trinity* because the forces of economics do not allow a country to simultaneously achieve all three goals.
Diff: 1
L.O.: 2.2 Fixed Versus Flexible Exchange Rates
Skill: Conceptual
AACSB: Application of knowledge

2.3 The Impossible Trinity

1) Which of the following is NOT an attribute of the "ideal" currency?
A) monetary independence
B) full financial integration
C) exchange rate stability
D) All are attributes of an ideal currency.
Answer: D
Diff: 1
L.O.: 2.3 The Impossible Trinity
Skill: Conceptual
AACSB: Application of knowledge

2) The authors discuss the concept of the "Impossible Trinity" or the inability to achieve simultaneously the goals of exchange rate stability, full financial integration, and monetary independence. If a country chooses to have a pure float exchange rate regime, which two of the three goals is a country most able to achieve?
A) monetary independence and exchange rate stability
B) exchange rate stability and full financial integration
C) full financial integration and monetary independence
D) A country cannot attain any of the exchange rate goals with a pure float exchange rate regime.
Answer: C
Diff: 2
L.O.: 2.3 The Impossible Trinity
Skill: Conceptual
AACSB: Application of knowledge

3) China today is a clear example of a nation that has chosen the following policies EXCEPT:
A) control and manage the value of its currency.
B) conduct an independent monetary policy.
C) full financial integration in an attempt to stimulate its domestic economy.
D) restrict the flow of capital into and out of the country.
Answer: C
Diff: 2
L.O.: 2.3 The Impossible Trinity
Skill: Conceptual
AACSB: Application of knowledge

2.4   A Single Currency for Europe: The Euro

1) Which of the following is NOT a required convergence criteria to become a full member of the European Economic and Monetary Union (EMU)?
A) National birthrates must be at 2.0 or lower per person.
B) The fiscal deficit should be no more than 3% of GDP.
C) Nominal inflation should be no more than 1.5% above the average inflation rate for the three members with the lowest inflation rates in the previous year.
D) Government debt should be no more than 60% of GDP.
Answer: A
Diff: 2
L.O.: 2.4 A Single Currency for Europe: The Euro
Skill: Recognition
AACSB: Application of knowledge

2) According to the authors, what is the single most important mandate of the European Central Bank?
A) Promote international trade for countries within the European Union.
B) Price, in euros, all products for sale in the European Union.
C) Promote price stability within the European Union.
D) Establish an EMU trade surplus with the United States.
Answer: C
Diff: 2
L.O.: 2.4 A Single Currency for Europe: The Euro
Skill: Conceptual
AACSB: Application of knowledge

3) Which of the following is a way in which the euro affects markets?
A) Countries within the Euro zone enjoy cheaper transaction costs.
B) Currency risks and costs related to exchange rate uncertainty are reduced.
C) Consumers and business enjoy price transparency and increased price-based competition.
D) all of the above
Answer: D
Diff: 1
L.O.: 2.4 A Single Currency for Europe: The Euro
Skill: Conceptual
AACSB: Application of knowledge

4) For the three years from early 2002 to early 2005, the euro maintained a strong and steady rise in value against the U.S. dollar (USD). After a brief respite in 2005, the euro continued its climb against the USD into 2008. Which of the following were NOT a contributing factor in the assent of the euro and the decline in the dollar?
A) severe U.S. balance of payments deficits
B) a general weakening of the dollar after the attacks of September 11, 2001
C) large U.S. balance of payment surpluses
D) All of the above were contributing factors.
Answer: C
Diff: 1
L.O.: 2.4 A Single Currency for Europe: The Euro
Skill: Conceptual
AACSB: Application of knowledge

5) The countries that use the euro as their currency have:
A) agreed to use a single currency (*exchange rate stability*), allow the free movement of capital in and out of their economies (*financial integration*), but give up individual control of their own money supply (*monetary independence*).
B) gained control over their own money supply (*monetary independence*), allowed the free movement of capital in and out of their economies (*financial integration*), but give up *exchange rate stability*.
C) agreed to use a single currency (*exchange rate stability*), allow individual control of their own money supply (*monetary independence*), but give up the free movement of capital in and out of their economies (*financial integration*).
D) none of the above
Answer: A
Diff: 2
L.O.: 2.4 A Single Currency for Europe: The Euro
Skill: Recognition
AACSB: Application of knowledge

6) The Euro currency is fixed against other currencies on the international currency exchange markets, but allows member country currencies to float against each other.
Answer: FALSE
Explanation: The Euro currency is floating against other currencies on the international currency exchange markets, but currencies of country members remain fixed against each other.
Diff: 1
L.O.: 2.4 A Single Currency for Europe: The Euro
Skill: Recognition
AACSB: Application of knowledge

7) The European Central Bank is a strong and independent central bank that has completely replaced the individual central banks of the countries that use the euro as their currency.
Answer: FALSE
Explanation: Individual central banks still exist to regulate banks within their borders.
Diff: 2
L.O.: 2.4 A Single Currency for Europe: The Euro
Skill: Recognition
AACSB: Application of knowledge

8) The members of the EU do have relative freedom to set their own *fiscal policies*—government spending, taxation, and the creation of government surpluses or deficits. They are expected to keep deficit spending within limits.
Answer: TRUE
Diff: 2
L.O.: 2.4 A Single Currency for Europe: The Euro
Skill: Recognition
AACSB: Application of knowledge

9) List and explain three benefits the euro would generate for the states participating in the European Economic and Monetary Union.
Answer: The euro would generate a number of benefits for the participating states: 1) Countries within the eurozone enjoy cheaper transaction costs; 2) Currency risks and costs related to exchange rate uncertainty are reduced; and 3) All consumers and businesses both inside and outside the eurozone enjoy price transparency and increased price-based competition. The primary "cost" of adopting the euro, the loss of monetary independence.
Diff: 1
L.O.: 2.4 A Single Currency for Europe: The Euro
Skill: Conceptual
AACSB: Application of knowledge

2.5 Emerging Markets and Regime Choices

1) Beginning in 1991 Argentina conducted its monetary policy through a currency board. In January 2002, Argentina abandoned the currency board and allowed its currency to float against other currencies. The country took this step because:
A) the Argentine Peso had grown too strong against major trading powers thus the currency board policies were hurting the domestic economy.
B) the United States required the action as a prerequisite to finalizing a free trade zone with all of North, South, and Central America.
C) the Argentine government lost the ability to maintain the pegged relationship as in fact investors and traders perceived a lack of equality between the Argentine Peso and the U.S. dollar.
D) all of the above
Answer: C
Diff: 2
L.O.: 2.5 Emerging Markets and Regime Changes
Skill: Recognition
AACSB: Application of knowledge

2) In January 2002, the Argentine Peso changed in value from Peso 1.00/$ to Peso 1.40/$, thus, the Argentine Peso ________ against the U.S. dollar.
A) strengthened
B) weakened
C) remained neutral
D) all of the above
Answer: B
Diff: 1
L.O.: 2.5 Emerging Markets and Regime Changes
Skill: Analytical
AACSB: Analytical thinking

3) In January 2000 Ecuador officially replaced its national currency, the Ecuadorian sucre, with the U.S. dollar. This practice is known as:
A) bi-currencyism.
B) securitization
C) a Yankee bailout.
D) dollarization.
Answer: D
Diff: 2
L.O.: 2.5 Emerging Markets and Regime Changes
Skill: Conceptual
AACSB: Application of knowledge

4) You have been hired as a consultant to the central bank for a country that has for many years suffered from repeated currency crises and depends heavily on the U.S. financial and product markets. Which of the following policies would have the greatest effectiveness for reducing currency volatility of the client country with the United States?
A) dollarization
B) an exchange rate pegged to the U.S. dollar
C) an exchange rate with a fixed price per ounce of gold
D) an internationally floating exchange rate
Answer: A
Diff: 2
L.O.: 2.5 Emerging Markets and Regime Changes
Skill: Conceptual
AACSB: Application of knowledge

5) Which of the following is NOT an argument against dollarization?
A) Dollarization causes a loss of sovereignty over domestic monetary policy.
B) Dollarization removes currency volatility against the dollar.
C) Dollarization causes the country to lose the power of seignorage.
D) The central bank of the dollarized country loses the role of lender of last resort.
Answer: B
Diff: 2
L.O.: 2.5 Emerging Markets and Regime Changes
Skill: Recognition
AACSB: Application of knowledge

6) The ability of a country to profit from its ability to print money is known as:
A) profiteering.
B) dollarization.
C) seignorage.
D) inflation.
Answer: C
Diff: 2
L.O.: 2.5 Emerging Markets and Regime Changes
Skill: Recognition
AACSB: Application of knowledge

7) Which of the following factors make it difficult for emerging market economies to choose a specific currency regime?
A) weak fiscal, financial, and monetary institutions
B) the tendency for commerce to allow currency substitution and the denomination of liabilities in dollars
C) the emerging market's vulnerability to sudden stoppages of outside capital flows
D) all of the above
Answer: D
Diff: 2
L.O.: 2.5 Emerging Markets and Regime Changes
Skill: Conceptual
AACSB: Application of knowledge

8) Of the following, which is NOT a trade-off that must be dealt with in any exchange rate regime?
A) cooperation vs independence
B) rules vs discretionary action
C) dollars vs pounds
D) All of the above are rate regime trade-offs.
Answer: C
Diff: 1
L.O.: 2.5 Emerging Markets and Regime Changes
Skill: Recognition
AACSB: Application of knowledge

9) The following are examples of degrees of internationalization of an international currency EXCEPT:
A) First degree of internationalization is when an international currency becomes readily accessible for trade.
B) A second degree of internationalization is when an international currency is used for international investment.
C) A third degree of internationalization is when an international currency is used for international investment.
D) A third degree of internationalization is when an international currency takes the role of a reserve currency.
Answer: C
Diff: 1
L.O.: 2.5 Emerging Markets and Regime Changes
Skill: Recognition
AACSB: Application of knowledge

10) A currency board exists when a country's central bank commits to back its money supply entirely with foreign reserves at all times.
Answer: TRUE
Diff: 1
L.O.: 2.5 Emerging Markets and Regime Changes
Skill: Recognition
AACSB: Application of knowledge

11) A currency board exists when a country's central bank commits to back a fraction of its money base with foreign reserves at all times.
Answer: FALSE
Explanation: A currency board exists when a country's central bank commits to back its money supply entirely with foreign reserves at all times.
Diff: 1
L.O.: 2.5 Emerging Markets and Regime Changes
Skill: Recognition
AACSB: Application of knowledge

12) Dollarization is a common solution for countries suffering from currency revaluation.
Answer: FALSE
Explanation: Dollarization is a solution for countries suffering from currency devaluation.
Diff: 1
L.O.: 2.5 Emerging Markets and Regime Changes
Skill: Recognition
AACSB: Application of knowledge

13) All exchange rate regimes must deal with the trade-off between rules and discretion as well as between cooperation and independence.
Answer: TRUE
Diff: 1
L.O.: 2.5 Emerging Markets and Regime Changes
Skill: Recognition
AACSB: Application of knowledge

14) Regime structures like the gold standard required no cooperative policies among countries, only the assurance that all would abide by the "rules of the game."
Answer: TRUE
Diff: 1
L.O.: 2.5 Emerging Markets and Regime Changes
Skill: Recognition
AACSB: Application of knowledge

15) Bretton Woods required less in the way of cooperation among countries than did the gold standard.
Answer: FALSE
Explanation: Bretton Woods required more in the way of cooperation among countries than did the gold standard.
Diff: 1
L.O.: 2.5 Emerging Markets and Regime Changes
Skill: Conceptual
AACSB: Application of knowledge

16) The People's Republic of China has two official currencies, the Chinese renminbi (RMB) and the yuan (CNY).
Answer: FALSE
Explanation: The People's Republic of China has a single official currency but recognizes the terms *reminbi* (RMB) and *yuan* (CNY) as names of its official currency. *Yuan* is used in reference to the unit of account, while the physical currency is termed the *renminbi*.
Diff: 1
L.O.: 2.5 Emerging Markets and Regime Changes
Skill: Conceptual
AACSB: Application of knowledge

17) Explain how all exchange rate regimes must deal with the trade-off between rules and discretion, as well as between cooperation and independence. List and classified two International Monetary Systems based on these four quadrants.
Answer: 1) Vertically, different exchange rate arrangements may dictate whether a country's government has strict intervention requirements (rules) or if it may choose whether, when, and to what degree to intervene in the foreign exchange markets (discretion). 2) Horizontally, the trade-off for countries participating in a specific system is between consulting and acting in unison with other countries (cooperation) or operating as a member of the system, but acting on their own (independence).
Regime structures like the gold standard required no cooperative policies among countries, only the assurance that all would abide by the "rules of the game." Under the gold standard, this assurance translated into the willingness of governments to buy or sell gold at parity rates on demand. The Bretton Woods Agreement, the system in place between 1944 and 1973, required more in the way of cooperation, in that gold was no longer the "rule," and countries were required to cooperate to a higher degree to maintain the dollar-based system. Exchange rate systems, like the European Monetary System's (EMS) fixed exchange rate band system used from 1979 to 1999, were hybrids of these cooperative and rule regimes.
Diff: 1
L.O.: 2.5 Emerging Markets and Regime Changes
Skill: Conceptual
AACSB: Application of knowledge

18) Dollarization is the use of the U.S. dollar as the official currency of the country. List and explain the arguments for and against dollarization. Provide example/s of countries that used the dollar as its official currency.
Answer: The arguments for dollarization are: 1) country that dollarizes removes any currency volatility (against the dollar) and would theoretically eliminate the possibility of future currency crises, 2) expectations of greater economic integration with other dollar-based markets, both product and financial. This last point has led many to argue in favor of regional dollarization. Three major arguments exist against dollarization. The first is the loss of sovereignty over monetary policy. This is, however, the point of dollarization. Second, the country loses the power of seigniorage, the ability to profit from its ability to print its own money. Third, the central bank of the country, because it no longer has the ability to create money within its economic and financial system, can no longer serve the role of lender of last resort. This role carries with it the ability to provide liquidity to save financial institutions that may be on the brink of failure during times of financial crisis.
Diff: 1
L.O.: 2.5 Emerging Markets and Regime Changes
Skill: Conceptual
AACSB: Application of knowledge