

# *Money, the Financial System, and the Economy, 6e (Hubbard)*

## Chapter 2 Money and the Payments System

### 2.1 Multiple Choice Questions

- 1) Many economists argue that the gain to European countries from all of them using the same currency
- A) would be very slight.
  - B) would be significant.
  - C) is impossible to measure.
  - D) would depend upon whether the new currency would be paper money or gold coins.

Answer: B

*Diff: 1*

*Question Status: Previous Edition*

- 2) The common currency in Europe is called the
- A) euro.
  - B) pound.
  - C) sovereign.
  - D) dollar.

Answer: A

*Diff: 1*

*Question Status: Previous Edition*

- 3) When was the common European currency introduced?
- A) 1914
  - B) 1945
  - C) 1970
  - D) 1999

Answer: D

*Diff: 1*

*Question Status: Previous Edition*

- 4) Movements in the money supply are associated with
- A) changes in interest rates and inflation, but not with changes in output.
  - B) changes in inflation and output, but not with changes in interest rates.
  - C) changes in interest rates and output, but not with changes in inflation.
  - D) changes in interest rates, inflation, and output.

Answer: D

*Diff: 1*

*Question Status: Previous Edition*

- 5) The most important reason why economies at an early stage of development tend to operate inefficiently is that
- A) they tend to be dominated by the agricultural sector, where productivity is usually low.
  - B) they tend to have authoritarian governments that stifle innovation.
  - C) they tend to be plagued by superstitious beliefs that stifle innovation.
  - D) they tend not to have specialization of labor.

Answer: D

*Diff: 2*

*Question Status: Previous Edition*

- 6) By "specialization" economists mean a situation where
- A) individuals produce the goods or services for which they have relatively the best ability.
  - B) goods are traded directly for goods and money is not used.
  - C) individuals who produce goods do not also produce services and individuals who produce services do not also produce goods.
  - D) individuals are assigned to occupations on the basis of tests that gauge their relative abilities.

Answer: A

Diff: 1

Question Status: Previous Edition

- 7) The most important economic benefit from specialization is that it
- A) makes it possible for an economy to begin using money.
  - B) leads to an increase in the standard of living in an economy.
  - C) makes barter possible.
  - D) eliminates the need for financial markets.

Answer: B

Diff: 2

Question Status: Previous Edition

- 8) When an economy relies on specialization,
- A) the economy will generally produce only one product.
  - B) the economy will usually be heavily agricultural.
  - C) each individual in the economy produces the goods or services for which he or she has relatively the best ability.
  - D) each individual will be assigned by the government to produce that good or service the government believes the economy should specialize in.

Answer: C

Diff: 2

Question Status: Previous Edition

- 9) Fundamentally, to reap the benefits of specialization, an economy must
- A) be heavily industrial.
  - B) be heavily agricultural.
  - C) have an extensive system of higher education.
  - D) develop ways for individuals to trade goods with one another.

Answer: D

Diff: 2

Question Status: Previous Edition

- 10) Barter is
- A) another name for money.
  - B) an exchange of goods and services directly for goods and services.
  - C) the basis for economic specialization.
  - D) the main system of exchange in the United States today.

Answer: B

Diff: 1

Question Status: Previous Edition

- 11) Under a system of barter
- A) each individual trades output directly with another.
  - B) only agricultural goods may be traded.
  - C) goods may be traded for money, but money may not be traded for goods.
  - D) currency is accepted for purchases, but personal checks are not.

Answer: A

Diff: 1

Question Status: Previous Edition

- 12) Which of the following is an example of a barter transaction?
- A) An individual pays her electric bill with a check.
  - B) An individual pays her electric bill with currency.
  - C) An individual provides three light bulbs to her neighbor in exchange for two gallons of milk.
  - D) An individual deposits three twenty-dollar bills in her checking account.

Answer: C

Diff: 1

Question Status: Previous Edition

- 13) In a barter system individuals
- A) find it impossible to specialize.
  - B) must be entirely self-sufficient.
  - C) find it difficult to specialize, but may be able to do so.
  - D) will almost invariably specialize.

Answer: C

Diff: 2

Question Status: Previous Edition

- 14) A system of barter has substantial transactions costs because
- A) taxes under such a system are generally a large fraction of the value of output.
  - B) traders must spend considerable time searching for trading partners.
  - C) the uncertainties of trade result in high legal fees being incurred to draw up binding contracts.
  - D) the uncertainties of trade result in high insurance premiums.

Answer: B

Diff: 2

Question Status: Previous Edition

- 15) Under a barter system
- A) each good has many prices.
  - B) each good has a single price.
  - C) no prices for goods exist.
  - D) prices for goods are very stable.

Answer: A

Diff: 1

Question Status: Previous Edition

16) How many prices would there be in a barter economy with 10 goods?

- A) 10
- B) 45
- C) 50
- D) 100

Answer: B

Diff: 3

Question Status: Previous Edition

17) The problem of a double coincidence of wants refers to

- A) the insatiability of wants in a free market economy.
- B) poorly-managed companies producing what consumers want only by coincidence.
- C) the necessity in a barter system of each trading partner wanting what the other has to trade.
- D) the likelihood that needs will not be the same as wants.

Answer: C

Diff: 1

Question Status: Previous Edition

18) Andy can't make a deal with Danny. Andy has a Barry Bonds baseball card and would like to trade it to Danny for Danny's Albert Pujols card, but Danny doesn't want a Barry Bonds card. Andy's problem illustrates the drawback to a barter system known as

- A) the specialization problem.
- B) the double coincidence of wants problem.
- C) the many prices problem.
- D) the transactions problem.

Answer: B

Diff: 1

Question Status: Revised

19) Which of the following is NOT a significant cost that a barter system imposes on an economy?

- A) Many prices must be maintained for each good.
- B) Only agricultural goods may be traded.
- C) Specialization of labor is hindered.
- D) The costs arising from the problem of finding two people who each want what the other produces.

Answer: B

Diff: 1

Question Status: Previous Edition

20) The collapse of economic systems in Eastern Europe during the late 1980s reveals that

- A) a barter system will not work.
- B) a barter system will work only in an advanced industrial country.
- C) government allocation of goods and services is not a successful replacement for the market system.
- D) the market system will work well only in an advanced industrial country.

Answer: C

Diff: 1

Question Status: Previous Edition

- 21) Which of the following is NOT true of allocating goods and services through a system of government rationing?
- A) No country has ever actually attempted to allocate goods and services in this way.
  - B) Shifts in the costs of producing individual goods and services will not be reflected in the trade accomplished by rationing.
  - C) Shifts in the values that consumers place on different goods and services will not be reflected in the trade accomplished by rationing.
  - D) Incentives to produce are reduced under such a system.

Answer: A

Diff: 1

Question Status: Previous Edition

- 22) Which of the following is the most efficient means of trade?
- A) Barter
  - B) Money
  - C) Government rationing
  - D) The combination of barter with some government rationing

Answer: B

Diff: 1

Question Status: Previous Edition

- 23) Money eliminates the need for
- A) any government role in the economy.
  - B) specialization.
  - C) people to have a double coincidence of wants.
  - D) the market system.

Answer: C

Diff: 1

Question Status: Previous Edition

- 24) Money is a medium of exchange in that
- A) money is generally accepted for buying and selling goods and services.
  - B) currency may be exchanged for gold at any national bank.
  - C) other assets may be better or worse in facilitating exchange than money.
  - D) it must maintain most of its value over time

Answer: A

Diff: 1

Question Status: New

- 25) Money as a medium of exchange refers only to
- A) currency.
  - B) gold coins.
  - C) anything that is generally accepted as payment for goods and services.
  - D) checks at commercial banks.

Answer: C

Diff: 1

Question Status: Previous Edition

- 26) Which of the following will lead to the most benefit in terms of greater prosperity?
- A) Several goods are recognized as mediums of exchange.
  - B) The government plays no role in choosing a medium of exchange.
  - C) A single good is recognized as a medium of exchange.
  - D) The medium of exchange is used only for the settlement of debts.

Answer: C

Diff: 2

Question Status: New

- 27) Using a good as a medium of exchange confers the benefit that
- A) the need to quote so many prices in trade is reduced.
  - B) the need for a double coincidence of wants is greatly increased.
  - C) the need for specialization is reduced.
  - D) transactions costs are increased, but they now may be paid in money terms.

Answer: A

Diff: 2

Question Status: Previous Edition

- 28) When economists refer to the role of money as a unit of account, they mean that
- A) most accounting systems reflect that goods are purchased with currency.
  - B) most accounting systems reflect that goods are purchased with checks.
  - C) money gives traders a way of measuring value in the economy.
  - D) money makes it possible for specialization to take place.

Answer: C

Diff: 1

Question Status: Previous Edition

- 29) When economists refer to the role of money as a store of value, they mean that
- A) money never loses its value, unlike other assets.
  - B) money allows value to be stored easily.
  - C) the value of money falls only when the quantity of money in circulation falls.
  - D) the value of money falls only when the quantity of money in circulation rises.

Answer: B

Diff: 2

Question Status: Previous Edition

- 30) An asset is
- A) the same thing as a liability.
  - B) a thing of value that can be owned.
  - C) money, as opposed to stock or bonds.
  - D) anything that never declines in value.

Answer: B

Diff: 1

Question Status: Previous Edition

- 31) The attribute that distinguishes money from other assets is that only money
- A) retains its value during times of inflation.
  - B) is counted in determining the size of an individual's wealth.
  - C) serves as a medium of exchange.
  - D) may be used as collateral for a bank loan.

Answer: C

Diff: 1

Question Status: Previous Edition

- 32) Wealth is
- A) the sum of the value of assets.
  - B) equal to income.
  - C) a flow variable.
  - D) the sum of the value of assets minus value of liabilities.

Answer: D

Diff: 2

Question Status: Previous Edition

- 33) The difference between money and income is that whereas income is an individual's
- A) flow of earnings over a period of time, money is an individual's stock of currency and currency substitutes.
  - B) stock of all assets, money is an individual's stock of currency and currency substitutes.
  - C) flow of earnings over a period of time, money is an individual's stock of all assets.
  - D) stock of currency and currency substitutes, money is an individual's stock of all assets.

Answer: A

Diff: 2

Question Status: Previous Edition

- 34) Which of the following is NOT a stock?
- A) Currency
  - B) Checking account balances
  - C) Income
  - D) Wealth

Answer: C

Diff: 2

Question Status: Previous Edition

- 35) In comparing money to shares of General Motors stock, we can say that
- A) money is a store of value, but shares of General Motors stock are not.
  - B) shares of General Motors stock are a store of value, but money is not.
  - C) both money and shares of General Motors stock are stores of value.
  - D) neither money nor shares of General Motors stock are stores of value.

Answer: C

Diff: 2

Question Status: Previous Edition

- 36) Why do individuals hold money when it does not provide the services that, say, a house does?
- A) Money is the most liquid asset.
  - B) Money is the only form in which wealth may be held.
  - C) Money increases in value faster than other assets.
  - D) Money is useful in avoiding taxes on certain transactions.

Answer: A

Diff: 2

Question Status: Previous Edition

- 37) Other assets are inferior to money in the sense that
- A) they increase in value more slowly than does money.
  - B) they have a lower overall return than money.
  - C) they are more vulnerable to losing their real value as inflation increases.
  - D) they generate transactions costs when they are exchanged for money.

Answer: D

Diff: 2

Question Status: Previous Edition

- 38) When economists refer to the role of money as a standard of deferred payment, they mean that
- A) payments by checks are usually deferred until the checks clear the bank.
  - B) money earns interest while loan payments are deferred.
  - C) money provides a standard for payments that will occur in the future.
  - D) money today is worth less than money tomorrow.

Answer: C

Diff: 1

Question Status: Previous Edition

- 39) The purchasing power of money
- A) rises when prices fall.
  - B) rises when prices rise.
  - C) is set by the Fed in January of each year.
  - D) is constant.

Answer: A

Diff: 2

Question Status: Previous Edition

- 40) When prices rise, the purchasing power of money
- A) rises.
  - B) falls.
  - C) is unaffected.
  - D) may rise, fall, or be unaffected depending upon circumstances.

Answer: B

Diff: 2

Question Status: Previous Edition

- 41) If the value of money increases over time, then we know
- A) the economy must be experiencing inflation.
  - B) the economy must be experiencing deflation.
  - C) economic growth must be very rapid.
  - D) economic growth must be very slow.

Answer: B

Diff: 2

Question Status: Previous Edition

- 42) Suppose \$100 buys less in the year 2007 than in 2000. Then we can say that
- A) there must have been inflation between 2000 and 2007.
  - B) there must have been deflation between 2000 and 2007.
  - C) the economy must have been growing rapidly between 2000 and 2007.
  - D) the economy must have been growing slowly between 2000 and 2007.

Answer: A

Diff: 2

Question Status: New



- 43) Eight cents earned in 1940 would have been able to buy goods and services worth how much today?
- A) \$0.10
  - B) \$0.20
  - C) \$1.00
  - D) \$10.00
- Answer: C  
Diff: 3  
Question Status: Previous Edition
- 44) A hyperinflation occurs when
- A) inflation persists for more than two years.
  - B) inflation persists for more than five years.
  - C) the inflation rate exceeds 1% per month.
  - D) the inflation rate exceeds 50% per month.
- Answer: D  
Diff: 2  
Question Status: Previous Edition
- 45) The experience of Argentina in the late 1980s illustrates the point that
- A) to be acceptable as a medium of exchange, households and firms must believe that money has value and will be acceptable.
  - B) any money not backed by gold will eventually become worthless.
  - C) even a country with very low inflation rates may have severe economic problems.
  - D) there is only a very slight link between rates of growth of the money supply and the inflation rate.
- Answer: A  
Diff: 2  
Question Status: Previous Edition
- 46) A "price index" is a
- A) summary statistic that reflects changes in the price of a group of goods and services relative to the price in a base year.
  - B) measure of the interest rate.
  - C) good whose price tends to increase and decrease at about the same rate as most other goods.
  - D) measure of economic growth.
- Answer: A  
Diff: 1  
Question Status: Previous Edition
- 47) Which of the following is NOT an important criterion for whether a good will be usable as a medium of exchange?
- A) The good must be of standardized quality.
  - B) The good must be valuable relative to its weight.
  - C) The good must have value even if it were not being used as money.
  - D) The good must be durable so that value is not lost through product spoilage.
- Answer: C  
Diff: 2  
Question Status: Previous Edition

- 48) Which criterion for suitability as a medium of exchange do Federal Reserve Notes meet?
- A) They are of standardized quality.
  - B) They are durable.
  - C) They are acceptable to most traders.
  - D) Federal Reserve Notes meet all of the criteria for suitability as a medium of exchange.

Answer: D

Diff: 2

Question Status: Previous Edition

- 49) What determines the acceptability of dollar bills as a medium of exchange?
- A) Our society's willingness to use green paper notes issued by the Federal Reserve as money
  - B) The willingness of the Federal Reserve to redeem dollar bills for gold
  - C) The willingness of the U.S. Treasury to redeem dollar bills for gold
  - D) The public's fear that failing to accept dollar bills will trigger a hyperinflation

Answer: A

Diff: 2

Question Status: Previous Edition

- 50) In what sense do self-fulfilling expectations determine the acceptability of a medium of exchange?
- A) People like to do what the government expects them to do.
  - B) People value something as money only if they believe others will accept it from them as payment.
  - C) People expect that money will never lose its value.
  - D) People expect that eventually every country will use the same medium of exchange.

Answer: B

Diff: 2

Question Status: Previous Edition

- 51) The payments system is
- A) the mechanism for conducting economic transactions.
  - B) another name for the system of foreign exchange rates.
  - C) the phrase used to describe how transactions are carried out in an economy that does not use money.
  - D) the way in which economic transactions are carried out in a government-controlled economy, such as the former Soviet Union.

Answer: A

Diff: 2

Question Status: Previous Edition

- 52) Definitive money
- A) is used only in primitive economies.
  - B) does not have to be converted into a more basic medium of exchange.
  - C) can be either gold or silver, but cannot be both.
  - D) is useful mainly for making purchases in foreign countries.

Answer: B

Diff: 2

Question Status: Previous Edition

- 53) The simplest type of payments system is
- A) the use of definitive money for trading goods and services.
  - B) the use of electronic funds transfers.
  - C) barter.
  - D) the use of checks issued against accounts at commercial banks for trading goods and services.

Answer: A

Diff: 2

Question Status: Previous Edition

- 54) Which of the following is an example of a commodity money?
- A) Gold coins
  - B) Dollar bills
  - C) British pound notes
  - D) Japanese yen notes

Answer: A

Diff: 1

Question Status: Previous Edition

- 55) All of the following are problems associated with commodity money EXCEPT
- A) it is a cumbersome form of payments system.
  - B) commodities tend to have little value in and of themselves.
  - C) its value is dependent on its purity.
  - D) costs were incurred in certifying the purity and weight of commodity money.

Answer: B

Diff: 2

Question Status: New

- 56) How was it possible for stamped and unstamped commodity money to circulate at the same time?
- A) It was not possible; the unstamped money drove the stamped money out of circulation.
  - B) It was not possible; the stamped money drove the unstamped money out of circulation.
  - C) The unstamped money was accepted at a discount to the stamped money.
  - D) The stamped money was accepted at a discount to the unstamped money.

Answer: C

Diff: 2

Question Status: Previous Edition

- 57) Fiat money
- A) is money that would have no value if it were not usable as money.
  - B) is illegal in most advanced, industrial countries.
  - C) is usually some type of precious metal.
  - D) will generally be accepted in trade for less than its face value.

Answer: A

Diff: 2

Question Status: Previous Edition

- 58) Which of the following is an example of fiat money?
- A) A cowry shell used as money on a South Pacific island
  - B) A gold coin used as money in nineteenth century England
  - C) A Federal Reserve Note used as money in the twenty-first century United States
  - D) A pound of salt used as money in medieval France

Answer: C

Diff: 1

Question Status: Revised

- 59) What is a "central bank"?
- A) Any commercial bank located in the capital of a country
  - B) The largest bank in a particular banking system
  - C) Any commercial bank that is willing to make loans to other commercial banks
  - D) A special governmental or quasi-governmental institution in the financial system that regulates the medium of exchange

Answer: D

Diff: 1

Question Status: Previous Edition

- 60) If money is declared to be legal tender, it must be
- A) minted from a precious metal.
  - B) acceptable to citizens of foreign countries.
  - C) possible to exchange it for an equivalent amount of precious metal.
  - D) accepted to settle private transactions and it must be used in paying taxes.

Answer: D

Diff: 1

Question Status: Previous Edition

- 61) By designating Federal Reserve currency as legal tender, the federal government
- A) has ensured that Federal Reserve currency will serve as money.
  - B) has guaranteed that Federal Reserve currency may be exchanged for an equivalent amount of gold or silver.
  - C) has mandated that Federal Reserve currency be accepted in discharge of debts.
  - D) has mandated that Federal Reserve currency be accepted by citizens of foreign countries in exchange for their countries' currencies.

Answer: C

Diff: 2

Question Status: Previous Edition

- 62) What is the most important factor for Federal Reserve currency to be accepted as money?
- A) Its acceptance by businesses and households in the United States in exchange for goods and services
  - B) Its designation as legal tender by the federal government
  - C) The willingness of the federal government to accept it in exchange for an equivalent amount of gold or silver coins
  - D) The willingness of foreign businesses and banks to accept it in exchange for goods and services

Answer: A

Diff: 2

Question Status: Previous Edition

- 63) In the United States, the definitive money is
- A) gold coins.
  - B) any coin minted from a precious metal.
  - C) Federal Reserve Notes.
  - D) Federal Reserve Notes plus checking account balances in commercial banks.

Answer: C

Diff: 2

Question Status: Previous Edition

- 64) In Moscow in 1989, what were taxi drivers using as a medium of exchange?
- A) Russian rubles
  - B) Marlboro cigarettes
  - C) Gold coins
  - D) Caviar

Answer: B

Diff: 2

Question Status: Previous Edition

- 65) In August 2006, what was the total value of Federal Reserve Notes in circulation?
- A) \$120 million
  - B) \$460 million
  - C) \$793 billion
  - D) \$6 trillion

Answer: C

Diff: 2

Question Status: New

- 66) Checks are
- A) not acceptable for settling transactions in most industrialized countries.
  - B) less important than currency as a means of settling transactions.
  - C) promises to pay definitive money on demand.
  - D) promises to pay coins minted from precious metals on demand.

Answer: C

Diff: 2

Question Status: Previous Edition

- 67) One advantage of using checks to settle transactions is
- A) they are more difficult to use fraudulently than currency or precious metals are.
  - B) there is effectively no cost to using them.
  - C) they are as liquid as cash.
  - D) there is no information cost involved in accepting them.

Answer: A

Diff: 3

Question Status: Previous Edition

- 68) The use of checks in transactions
- A) entails lower information costs than the use of currency.
  - B) entails fewer steps than settling transactions with currency.
  - C) avoids the cost of shipping currency back and forth.
  - D) entails lower information and fewer steps than settling transactions with currency.

Answer: C

Diff: 2

Question Status: Previous Edition

69) Automatic teller machines and debit cards are examples of

- A) electronic funds transfer systems.
- B) commodity monies.
- C) legal tender in the United States.
- D) modern barter systems.

Answer: A

Diff: 1

Question Status: Previous Edition

70) What do many economists blame for the severity of the Great Depression?

- A) The collapse of the banking system
- B) The lack of a definitive money in the U.S. monetary system
- C) The issuing of an excessively large amount of currency by the Federal Reserve
- D) The collapse of the electronic funds transfer system

Answer: A

Diff: 1

Question Status: Previous Edition

71) When economists refer to substitutability in discussing money, they are referring to

- A) the rate at which households substitute work for leisure in exchange for money.
- B) the rate at which one country's currency can be substituted for another country's currency.
- C) the ease with which an asset can be converted into definitive money with no loss of value.
- D) the ease with which currency can be converted into silver or gold.

Answer: C

Diff: 2

Question Status: Previous Edition

72) A monetary aggregate is a measure of

- A) the inflation rate.
- B) the total economic activity of the country.
- C) money broader than currency.
- D) definitive money.

Answer: C

Diff: 1

Question Status: Previous Edition

73) The narrowest money measure is

- A) currency plus checking accounts at commercial banks.
- B) currency plus all checking accounts.
- C) currency plus all deposits at financial institutions.
- D) definitive money.

Answer: B

Diff: 2

Question Status: Previous Edition

74) Which of the following is the largest measure of money?

- A) Federal Reserve notes
- B) definitive money
- C) M1
- D) M2

Answer: D

Diff: 2

Question Status: New

75) Which of the following is NOT included in M1?

- A) Currency
- B) Savings account deposits
- C) Checking account deposits
- D) Traveler's checks

Answer: B

Diff: 1

Question Status: Previous Edition

76) All of the following are examples of electronic funds EXCEPT

- A) credit cards.
- B) debit cards.
- C) stored value cards.
- D) e-cash.

Answer: A

Diff: 1

Question Status: New

77) The M2 aggregate

- A) includes M1 plus short-term investment accounts.
- B) includes M1 plus large-denomination time deposits.
- C) equals currency plus checking account deposits at commercial banks.
- D) is the best definition of definitive money.

Answer: A

Diff: 2

Question Status: Previous Edition

78) Which of the following is NOT included in M2?

- A) Currency
- B) Savings bonds
- C) Money market deposit accounts
- D) Overnight repurchase agreements

Answer: B

Diff: 2

Question Status: Previous Edition

79) Which of the following statements is true about M2?

- A) Its total value is smaller than that of M1.
- B) Apart from those assets also included in M1, it includes no assets that offer check-writing features.
- C) Its total value is about five times as large as M1.
- D) It includes large-denomination time deposits.

Answer: C

Diff: 2

Question Status: Revised





- 85) The Fed's current position towards the existing monetary aggregates is
- A) it is convinced that  $M1$  is the best measure of the money supply.
  - B) it is convinced that  $M2$  is the best measure of the money supply.
  - C) it is experimenting with new monetary aggregates.
  - D) it is reverting to considering currency alone as the best measure of the money supply.

Answer: C

Diff: 2

Question Status: Revised

- 86) In 2006, the Fed stopped reporting data on which monetary aggregate?
- A)  $M1$
  - B)  $M2$
  - C)  $M3$
  - D)  $M4$

Answer: C

Diff: 2

Question Status: New

- 87) Suppose the GDP implicit price deflator was 112.7 in 2005 and 116.0 in 2006. Therefore, the inflation rate in 2006 would be
- A) 2.8%.
  - B) 2.9%.
  - C) 3.3%.
  - D) 16%.

Answer: B

Diff: 2

Question Status: New

- 88) The GDP implicit price deflator was 112.7 in 2005 and 116.0 in 2006. Therefore, the increase in the price level between the base year and 2006 was
- A) 2.8%.
  - B) 2.9%.
  - C) 3.3%.
  - D) 16%.

Answer: D

Diff: 2

Question Status: New

## 2.2 Essay Questions

- 1) The American Civil War lasted from the spring of 1861 to the spring of 1865. During the war the Confederate government issued substantial amounts of fiat paper currency. What do you think happened to the price level (measured in Confederate dollars) in the Confederate states during the final months of the war?

Answer: During the final months of the war, the imminent demise of the Confederate government greatly reduced the willingness of people to hold Confederate currency. The usefulness of Confederate currency as a store of value and as a standard of deferred payment declined sharply. Those attempting to buy goods and services with the currency had to offer increasing amounts of it in order to find anyone willing to accept it. Or, put another way, the price level rose dramatically, measured in Confederate dollars.

Question Status: Previous Edition

- 2) Most economists believe that the adoption of the euro as the common currency of most countries in the European Community will result in significant economic gains to those countries. Discuss the nature of these economic gains.

Answer: The cost of converting currency in commercial and financial transactions will be eliminated and the European market will become more unified.

*Question Status: Revised*

- 3) What criteria should be used in deciding the best definition of the money supply?

Answer: The answer depends on the purpose of the measurement. Economists are primarily interested in the relation between monetary aggregates and other economic variables, such as output, the price level, and interest rates. In this respect, a monetary aggregate is most useful when it is most closely related to these economic variables. Until the 1980s, *M1* was the most widely accepted measure of the money supply. In the 1980s and 1990s, *M2* has been most widely accepted.

*Question Status: Previous Edition*

- 4) Economic studies have shown that countries that have high inflation rates have lower rates of economic growth than do countries with low inflation rates. Explain what underlies this relationship between inflation and economic growth.

Answer: In terms of the issues discussed in this chapter, inflation reduces the usefulness of currency as a store of value and as a standard of deferred payment. In extreme cases, high rates of inflation have led to a shift to a barter system or to the use of foreign currency as a medium of exchange. These effects would tend to reduce the efficiency of the economy and the rate of economic growth.

*Question Status: Previous Edition*