Student name:\_\_\_\_\_\_\_\_\_\_

**MULTIPLE CHOICE - Choose the one alternative that best completes the statement or answers the question.
1)** Which one of the following would *not* be considered a characteristic of money?

 A) It is a store of value.
 B) It is a means of payment.
 C) It must have intrinsic value.
 D) It is a unit of account.

**2)** A system of barter

 A) does not permit the exchange goods and services.
 B) requires that people do everything for themselves.
 C) requires exchange of goods and services without money.
 D) is efficient since people are self-sufficient.

**3)** A society without any money

 A) would have to rely on barter.
 B) would have no exchange of goods and services.
 C) would have individuals doing everything for themselves.
 D) would be more efficient due to more self-sufficiency.

**4)** The use of money makes an economy more efficient because

 A) people spend more time trading and more time producing.
 B) people can specialize in what they do well.
 C) with money, people will borrow less.
 D) money increases in value over time.

**5)** The unit of account characteristic of money

 A) makes it difficult to compare the relative prices of goods and services.
 B) refers to how we use money to transfer purchasing power over time.
 C) means prices are expressed in terms of money.
 D) means that money finalizes payments.

**6)** Without the use of money, workers in an economy would

 A) become more specialized.
 B) have to spend a lot less time trading.
 C) probably specialize less.
 D) be far more productive.

**7)** As an economy without money produces more different types of goods,

 A) it is more difficult to quote prices.
 B) the number of relative prices decreases.
 C) a unit of account is easier to define.
 D) buyers are more likely to have full information about sellers.

**8)** The store of value characteristic of money refers to the fact that

 A) people save most of their money.
 B) money allows people to shift purchasing power into the future.
 C) money is not valuable unless it is stored.
 D) money is the only way people have to store value.

**9)** Stocks and bonds that are held as wealth fulfill which one of the functions of money?

 A) means of payment
 B) store of value
 C) unit of account
 D) medium of exchange

**10)** Which best describes money as a means of payment?

 A) Money provides an immediate double coincidence of wants.
 B) Money makes sure a double coincidence of wants never occurs.
 C) Money requires at least two transactions to obtain the double coincidence of wants.
 D) To obtain a double coincidence of wants without money is impossible.

**11)** When comparing the exchange of goods and services in a barter economy and an economy that uses money,

 A) a double coincidence of wants is necessary in the barter economy.
 B) a double coincidence of wants is more likely to occur in the barter economy.
 C) transactions are likely to be smoother in the barter economy because goods and services are exchanged directly.
 D) the money economy requires that sellers have more information about buyers' wants.

**12)** In a barter system, people

 A) have to specialize in order to have goods to trade.
 B) cannot specialize because they never know what goods will be desired.
 C) are less likely to specialize as extensively as they would in a monetary economy.
 D) must be self-sufficient.

**13)** In a barter economy, prices are stated in terms of relative prices. In a barter economy where the only goods are oranges, rafts, and flower necklaces, how many prices would a trader of oranges need to know?

 A) 3
 B) 5
 C) 6
 D) 9

**14)** In a barter economy, prices are stated in terms of relative prices. How many prices would a trader of a particular good need to know in a barter economy with 5 goods?

 A) 5
 B) 10
 C) 20
 D) 50

**15)** In a barter economy, prices are stated in terms of relative prices. How many prices would a trader of a particular good need to know in a barter economy with 20 goods?

 A) 190
 B) 100
 C) 20
 D) 40

**16)** In a barter economy, where prices are stated in terms of relative prices, with *n* number of goods there will always be

 A) exactly *n* relative prices.
 B) fewer than *n* relative prices.
 C) at least *n* relative prices.
 D) *n*/2 relative prices.

**17)** Which one of the following is the primary source of the high transaction costs associated with a barter system?

 A) The fact that, often times, these exchanges are taxed by governments
 B) The risk associated with having to carry an inventory of goods to trade
 C) The high cost associated with finding someone with whom to exchange
 D) The cost of drawing up complete contracts

**18)** Suppose that in a barter economy Tom bakes bread and Hans produces chocolates. Tom wants chocolates but Hans doesn't like bread, so Hans is unwilling to trade with Tom. Tom's problem is an example of which problem associated with a barter system?

 A) too much specialization
 B) not enough prices
 C) the law of diminishing returns
 D) the double coincidence of wants problem

**19)** Specialization usually increases the output of a country; however, effective specialization requires

 A) that everyone in the country produce the same thing.
 B) that workers have very similar skills.
 C) an effective low-cost means to exchange goods and services.
 D) a large stock of capital.

**20)** Which one of the following is an example of bartering?

 A) Sue trading candles with Tom for his bread
 B) Mary paying for her new shoes with her credit card
 C) John cutting his neighbor's grass in return for a cash payment
 D) Mrs. Smith giving each of the neighbor children $5.00 after they helped clean up her yard

**21)** Money eliminates the need for

 A) a search for a double coincidence of wants.
 B) government regulation.
 C) specialization of labor.
 D) financial intermediaries.

**22)** Money that is used as a means of payment must be

 A) actual currency.
 B) coins and currency.
 C) coins, currency and credit cards.
 D) anything that is generally accepted as payment for goods and services.

**23)** While money is an asset, not all assets are money because

 A) only money stores value.
 B) money must work as a means of payment.
 C) only money is a good asset to hold during times of inflation.
 D) money must be legal tender.

**24)** An advantage that money has over other assets is that it

 A) increases in value over time.
 B) has lower transaction costs to use as a means of payment than other assets.
 C) provides a higher return to the owner.
 D) is a safer asset to hold during times of inflation.

**25)** An individual who stores wealth in art rather than money will find that they

 A) suffer larger real losses during periods of high inflation.
 B) have far more liquidity than most savers.
 C) will incur higher transaction costs when they ultimately make purchases.
 D) will have to resort to barter exchanging the art for desired goods.

**26)** Which one of the following best describes how money and wealth are related?

 A) Money is wealth but not all wealth is money.
 B) Money is a means of payment but is not part of wealth.
 C) Assets that are part of wealth always havea positive return while money does not.
 D) Wealth is a store of value and a means of payment while money is only a means of payment.

**27)** Which one of the following is an example of fiat money?

 A) silk in China
 B) butter in Norway
 C) gold in Venice
 D) U.S. currency

**28)** For most of human history, which one of the following has been the most common commodity money?

 A) silk
 B) butter
 C) gold
 D) U.S. currency

**29)** Gold would be a superior commodity money compared to wheat because

 A) wheat has a high value relative to weight, which gold does not.
 B) it is easier to divide wheat into small units.
 C) wheat has more practical uses than gold.
 D) wheat is perishable.

**30)** The fact that U.S. currency is legal tender means

 A) U.S. currency is good anywhere in the world.
 B) the only money the government will accept for settlement of debts is U.S. currency.
 C) private businesses in the U.S. and the U.S. government must accept currency for payment.
 D) it cannot be backed by gold or other metals.

**31)** In comparing money to a U.S. Treasury bond held by an individual,

 A) the Treasury bond is an asset but money is not.
 B) money is an asset but the U.S. Treasury bond is a liability of the individual.
 C) both are stores of value.
 D) money is a store of value but the U.S. Treasury bond is not.

**32)** In comparing money to a U.S. Treasury bond held by an individual, we can say

 A) both are legal tender.
 B) both are units of account.
 C) only the bond is legal tender since it is an obligation of the U.S. government.
 D) both are stores of value.

**33)** In comparing money to a share of Microsoft stock held by an individual, we can say

 A) the share of stock is an asset, but money is a liability.
 B) only the money is a means of payment, but both are stores of value.
 C) only the money is a means of payment, but both are units of account.
 D) both the Microsoft stock and the money are liabilities.

**34)** Comparing checks and currency, we can say

 A) both are money but only currency is legal tender.
 B) only checks are both money and legal tender.
 C) a check isn't money but currency is.
 D) both are money and legal tender.

**35)** When the Continental Congress issued currency to finance the Revolutionary War, the Continental Congress

 A) issued too many Continentals, eventually making the currency worthless.
 B) tied the value of the Continental to gold.
 C) tied the value of the Continental to French assignats.
 D) issued too few Continentals which kept them from being widely accepted.

**36)** During the Civil War, the North issued currency, known as greenbacks. These greenbacks

 A) are still legal tender in the United States.
 B) were tied to the value of gold and silver.
 C) were used by the South to pay for salaries and supplies.
 D) are a historical example of commodity money.

**37)** Most of the non-cash retail payments made each year in the United States are made by

 A) check.
 B) credit card.
 C) debit card.
 D) electronic funds transfers.

**38)** All of the following are true about electronic funds transfers except they

 A) sometimes involve the Federal Reserve sending electronic images of checks to banks.
 B) occur when banks or individuals deposit/withdraw from one bank account to another electronically.
 C) include automated clearinghouse transactions (ACH).
 D) include credit card payments made online.

**39)** Carlos pays his cable bill using his bank's internet banking web site to withdraw funds from his checking account. This transaction is a(n)

 A) automated clearinghouse transaction (ACH).
 B) digitized-check transaction.
 C) e-money transaction.
 D) Fedwire transaction.

**40)** Consider the path of a paper check as it travels through the check-clearing system. Which step in the process uses money?

 A) when the consumer hands the check to the merchant
 B) when the merchant’s bank sends an electronic image of the check to the local Federal Reserve Bank
 C) when the Federal Reserve credits the merchant’s bank’s reserve account and debits the consumer’s bank’s reserve account
 D) when the consumer’s bank debits the consumer’s checking account by the amount of the check

**41)** The value of fiat money

 A) comes from its intrinsic value.
 B) is worth more as a commodity than its value as money.
 C) comes from government decree.
 D) means that it is more desirable than currency.

**42)** U.S. currency is

 A) a commodity money.
 B) fiat money.
 C) tied to the value of gold at a fixed rate.
 D) the only store of value.

**43)** One major difference between a debit card and a credit card is that

 A) only the debit card helps you to build a credit history.
 B) the debit card has lower minimum monthly payments.
 C) you do not need to actually have the funds in your account when you use a debit card.
 D) debit cards have no late fees.

**44)** One major difference between a debit and credit card is

 A) you can build a credit history with the credit card but not with the debit card.
 B) you have to pay interest on your purchases if you use a credit card.
 C) credit cards are money and the debit card is not.
 D) debit cards charge late fees.

**45)** An asset that is liquid

 A) physically takes a liquid form, like oil.
 B) may be readily converted into a means of payment.
 C) is any asset that can be sold.
 D) must be U.S. currency.

**46)** One advantage of using checks over a debit card is that

 A) checks can be replaced if lost or stolen, a debit card cannot.
 B) the bank is responsible if someone steals your checks and uses them; this isn't the case with debit cards.
 C) a cancelled paper check is the only generally accepted proof of payment.
 D) the person has "float," meaning time between writing the check and depositing funds to cover it.

**47)** Checks and currency function similarly, except that

 A) currency is a more effective means of payment.
 B) carrying currency entails greater risk because it cannot be replaced if lost or stolen.
 C) currency is a better store of value than checking deposits.
 D) checks are not included in measures of money, whereas currency is.

**48)** Apps and smartphone infrastructure such as Apple Pay, Google Pay, PayPal, and Venmo

 A) reduce the costs and decrease the speed of payments and transfers.
 B) reduce the costs and increase the speed of payments and transfers.
 C) increase the costs and decrease the speed of payments and transfers.
 D) increase the costs and increase the speed of payments and transfers.

**49)** Money aggregates can best be defined as a set of measures of the amount of

 A) money that exists at a particular point in time.
 B) money the Federal Reserve has on deposit as reserves.
 C) money available to the economy over a year.
 D) U.S. currency the Bureau of Printing and Engraving has produced.

**50)** The money aggregate M1 includes each of the following, except

 A) currency in the hands of the public.
 B) other checkable deposits.
 C) savings deposits.
 D) demand deposits at commercial banks.

**51)** Which one of the following is the largest category of M1?

 A) currency in the hands of the public
 B) other checkable deposits
 C) savings deposits
 D) demand deposits at commercial banks

**52)** The money aggregate M2 includes

 A) large denomination time deposits.
 B) stock and bond mutual fund shares.
 C) institutional money market funds.
 D) M1.

**53)** An automobile is an asset, but it is not liquid because

 A) the transactions costs for turning it into money are high.
 B) the owner may still be making payments on the loan.
 C) the automobile may not be in good repair.
 D) the automobile cannot be sold without a loss in value.

**54)** With inflation,

 A) you need less money to buy the same basket of goods you bought a month or a year ago.
 B) money is more valuable.
 C) there is too little money in circulation.
 D) prices, in general, are increasing over time.

**55)** Which one of the following lists correctly orders assets from most liquid to least liquid?

 A) stocks, house, paper currency, savings deposits
 B) stocks, paper currency, house, savings deposits
 C) savings deposits, paper currency, house, stocks
 D) paper currency, savings deposits, stocks, house

**56)** Which one of the following assets is the most liquid?

 A) art
 B) demand deposits
 C) houses
 D) stocks

**57)** Which one of the following assets is least liquid?

 A) common stock
 B) houses
 C) art
 D) checking account deposits.

**58)** Considering the roughly $1.6 trillion in U.S. currency held by the public,

 A) over 90 percent of the amount is held in the form of $1 bills.
 B) more than three-fourths is held in the form of $100 bills.
 C) over half of the currency held in the form of $20 bills.
 D) the Federal Reserve distributes the amount equally across all denominations of bills.

**59)** Ava buys a $2,000 computer using a paper check. At which step does $2,000 get recorded in M1?

 A) when Ava hands the $2,000 check to the computer merchant
 B) once the $2,000 is credited to the merchant bank's reserve account and is debited from Ava's bank account
 C) once the Federal Reserve sends the paper check (or an electronic image) to Ava's bank
 D) The check is never M1. The $2,000 is M1 both in Ava's bank account and, later, in the merchant's account. It is the deposit balance that is counted.

**60)** Which statement best summarizes how monetary aggregates are used to understand inflation?

 A) Economists and policymakers use M1 to understand inflation today.
 B) M1 and M2 move together so both are good measures to use for understanding inflation.
 C) In recent years, growth in M2 has stopped being a useful tool for forecasting inflation.
 D) Especially when inflation is low, M2 is useful for understanding inflation.

**61)** Gross Domestic Product in the United States is roughly

 A) equal to M1.
 B) twice as large as M2.
 C) equal to M2.
 D) more than five times M1.

**62)** M1 is

 A) about 18% of GDP.
 B) equal to GDP.
 C) about four times larger than GDP.
 D) about one fourth the amount of GDP.

**63)** M1 is

 A) a more useful measure of the relationship between the money supply and inflation because it includes the most liquid assets.
 B) the money supply the Federal Reserve pays the most attention to in conducting monetary policy.
 C) less useful than M2 for understanding inflation.
 D) the fastest growing of all of the money aggregates.

**64)** M1 has decreased in its usefulness in understanding inflation due to

 A) the increased use of checks in the economy.
 B) the introduction of money market mutual fund shares and similar checking substitutes.
 C) more reliance on the use of currency.
 D) the increased use of electronic payments.

**65)** The introduction of money market substitutes for basic checking accounts was fueled partially by the

 A) relatively high rates of inflation that existed in the late 1970s and early 1980s.
 B) reluctance of many retailers to accept checks.
 C) high number of bank failures that were occurring in the 1970s.
 D) higher interest rates banks had to pay on checking accounts.

**66)** A cross-country analysis of money growth supports the conclusion that the correlation between

 A) the growth rate of the quantity of money and the rate of inflation does not exist.
 B) the money growth rate and inflation in most countries was positive but very small.
 C) inflation and money growth in most industrialized countries was actually negative.
 D) inflation and the money growth rate was positive and relatively strong.

**67)** A cross-country analysis of money growth shows that the growth rate in the money supply was

 A) lower in countries with lower inflation rates.
 B) higher in countries with lower inflation rates.
 C) lower in countries with higher inflation rates.
 D) the same whether the countries had high or low inflation rates.

**68)** The Consumer Price Index (CPI) is

 A) an example of an index that uses variable expenditure weights.
 B) a fixed-expenditure-weight index used to measure changes in the GDP Deflator.
 C) a fixed-expenditure weight-index used to measure changes in purchasing power for households.
 D) the least commonly used measure of inflation.

**69)** The Consumer Price Index (CPI)

 A) tends to understate the impact of price changes.
 B) tends to overstate the impact of price changes due to substitution bias.
 C) is more accurate than the GDP deflator.
 D) assumes that consumers substitute away from cheaper goods.

**70)** Assume that people spend 30 percent of their income on food, 45 percent on housing, and 25 percent on transportation. Assume that 2020 is the base year, and use the table below to compute the Consumer Price Index (CPI) for 2021:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Year | Price of Food | Price of Housing | Price of Transportation | Cost of the Basket |
| 2020 | $100 | $200 | $100 | $145 |
| 2021 | $120 | $210 | $150 | $168 |
|  |

 A) 23
 B) 100
 C) 116
 D) 156.5

**71)** The Consumer Price Index (CPI)

 A) is calculated using a basket of goods and services adjusted annually by government statisticians.
 B) answers the question, "How much more does it cost today to buy the same basket of goods and services that were purchased at some fixed time in the past?"
 C) does not suffer from substitution bias because the basket used to measure prices changes every year.
 D) understates the impact of price changes.

**72)** Economists study the link between money and inflation because

 A) they want to understand how to keep inflation low and stable.
 B) they believe that inflation in the 3–6 percent range is healthy for an economy.
 C) as prices increase money becomes more valuable.
 D) the Fed needs to increase the money supply as prices increase.

**73)** Inflation refers to growth in an economy’s

 A) Gross Domestic Product (GDP).
 B) interest rates.
 C) money.
 D) prices.

**74)** When the price level increases, the purchasing power of money

 A) increases by a similar amount.
 B) stays the same since the purchasing power of money is not impacted by price levels.
 C) decreases.
 D) first increases and then decreases as people get used to higher prices.

**75)** The purchasing power of money

 A) rises when inflation rises.
 B) decreases as the price level decreases.
 C) decreases with inflation.
 D) is not impacted by inflation, only by monetary policy.

**76)** If you can buy the same goods this year as you bought last year

 A) with less money there must have been deflation.
 B) with the same amount of money, prices are unstable.
 C) but it requires more money, there must have been price instability.
 D) with the same money there must have been deflation.

**77)** According to the World Bank, in 2017, what fraction of the world’s adults do not have an account at a bank or a mobile money operator?

 A) zero
 B) about one-third
 C) about one-half
 D) between one-half and two-thirds

**78)** In countries with low inflation,

 A) M2 growth is a very strong forecaster of inflation.
 B) there tends to be a greater reliance on checks than electronic payments.
 C) M2 growth is a poor forecaster of inflation.
 D) money stocks are a larger percentage of GDP.

**79)** Sue uses a credit card to purchase a new pair of jeans. Sue is

 A) using money to buy her jeans since credit cards is money.
 B) creating a liability that she will ultimately have to pay with money.
 C) using an electronic payment form of money.
 D) using a form of money included in M2.

**80)** The value of money as a means of payment

 A) is independent of changes in the amount of money in the economy.
 B) is fixed once relative prices are set.
 C) depends on the amount of money in the economy, among other things.
 D) depends on whether the majority of M1 is in currency or demand deposits.

**81)** The primary concern of current critics of fiat money is that

 A) fiat money is too costly to produce.
 B) governments issue too much money, threatening its value.
 C) fiat money is too easy to counterfeit.
 D) governments will issue too little, threatening economic growth.

**82)** Why would current critics of fiat money urge governments to return to a gold standard?

 A) They fear that governments will issue too much money.
 B) They fear that central banks will start making currency out of plastic.
 C) They believe that politicians need more discretion to make policy time consistent.
 D) They worry that governments will stop accepting the currency it has issued.

**83)** Which function of money has already undergone big changes as technology has evolved?

 A) means of payment
 B) store of value
 C) unit of account
 D) store of deferred payment

**84)** What makes critics of cryptocurrencies say that this is not money?

 A) Users can remain anonymous while making payments.
 B) Electronic payments are efficient.
 C) They lack the three key characteristics of money.
 D) Their value can be undermined by government fiat.

**85)** Which one of the following is a drawback to the use of blockchain technology?

 A) less efficient
 B) lack of oversight
 C) less costly
 D) innovative

**86)** A policy is time consistent when

 A) policymakers have incentives to adhere to a policy decision made today, in the future.
 B) policymakers have incentives to make policy decisions in a time-sensitive fashion.
 C) policymakers consider the future when making current policies.
 D) the timing of a policy is irrelevant.

**SHORT ANSWER. Write the word or phrase that best completes each statement or answers the question.
87)** Consider the following: there are two countries, A and B. Each country has the same resources, and produces the same goods. The residents of country A use money while the residents of country B rely on bartering of goods. Will each country produce the same quantity of output? Explain.

**88)** Consider an island where people use sand dollars (shells) as currency. For simplicity, assume that the people consume only one good: fish.a. Currently, there are 400 sand dollars in circulation and there are 200 fish purchased each year. Based on this information, what is the price of fish?b. Suppose that a change in climate leads to new sand dollars washing ashore, leaving a total of 500 sand dollars in the economy. If there are still 200 fish purchased each year, what is the new price of fish? In order to prevent inflation, what would have to happen to the amount of fish purchased each year?

**89)** What does it mean to say that an asset is "liquid"?

**90)** There are three goods produced in an economy by three individuals.

|  |  |
| --- | --- |
| Good | Producer |
| apples | orchard owner |
| bread | baker |
| chocolate | candy maker |
|  |

If the orchard owner likes only bread, the baker likes only chocolate, and the candy maker likes only apples, will any trade between these three persons take place in a barter economy? Explain.

**91)** Many college campuses use student ID cards as a way for students to pay for on-campus expenses such as books, photocopies, and food. For convenience, some students will maintain a balance on their ID cards. Are these balances a means of payment? Are they a store of value? Explain why or why not.

**92)** Use the information in the table below to answer the questions that follow. Assume that 2020 is the base year and that the market basket includes 5 units of Good A, 15 units of Good B, and 40 units of Good C.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Year | Price of Good A | Price of Good B | Price of Good C | Cost of Market Basket | Consumer Price Index |
| 2020 | $100 | $80 | $240 |  |  |
| 2021 | $150 | $80 | $300 |  |  |
| 2022 | $200 | $120 | $360 |  |  |
|  |

a. Find the cost of the market basket for each year and fill in the column in the table.b. Find the CPI for each year and fill in the column in the table.

**93)** Explain why the following statement is true, "money is an asset but not all assets are money."

**94)** Explain how money solves the problem of the "double coincidence of wants."

**95)** Suppose there is an economy that has 100 people each of whom makes a different good, and they use a barter system for exchange. How many relative prices will there be?

**96)** Is the characteristic that distinguishes money from other assets its ability to be a store of value?

**97)** What distinguishes commodity money from fiat money?

**98)** During the U.S. Civil War the Confederate government had to resort to printing currency to obtain the goods they needed. Comment on what you think happened to both prices and the value of this currency at the end of the war.

**99)** You purchase a good by writing a check for $1,000. Considering the financial payments system this check follows, when is the check money? Explain.

**100)** Explain why credit cards are not considered money even though people seem to use them like money.

**101)** Explain the difference(s) between a debit card and a credit card.

**102)** Rank the following assets from most liquid to least liquid.a) common stockb) housesc) currencyd) arte) savings accountsf) checking account deposits.

**103)** During what period was money a better store of value: 1960–1980 or 1990–2009? Explain.

**104)** What is included in M2 that is not included in M1?

**105)** Have the growth rates of M1 and M2 moved together over time? Explain.

**106)** How useful is M2 in tracking inflation? Explain.

**107)** Has M2 always been a useful tool for forecasting inflation? Explain.

**108)** Why do economists claim the Consumer Price Index (CPI) tends to overstate the actual rate of inflation?

**109)** What does a CPI of 240 mean?

**110)** How has the Bureau of Labor Statistics (BLS) changed the calculation of the CPI in order to take substitution bias into account?

**111)** What was the double liquidity shock that occurred in the U.S financial system in the summer of 2007?

**112)** Why are electronic transactions increasingly taking the place of paper transactions?

**ESSAY. Write your answer in the space provided or on a separate sheet of paper.
113)** Consider two barter economies: Duos and Varietas. Duos produces two different goods, whereas Varietas produces 80 different goods. Both countries have the same number of people. In which barter economy is it more likely that the means of payment and the units of account would be efficient? How many relative prices are there in Duos compared with Varietas? Which economy would benefit more from adopting money?

**114)** After the Revolutionary War, the United States monetary system was based on gold. Historically, why did the United States adopt the use of gold as a currency? How does this compare with the currency used today?

**115)** Historically, some governments have relied on the revenue generated from printing currency to finance government spending. Give two examples of government's relying on paper currency to finance wartime expenditures. What do you expect happened to inflation rates during these historical episodes?

**116)** In the chapter you read that it costs the U.S. Treasury's Bureau of Engraving and Printing around 5.5 cents to print a $1 bill, 10.5 cents to print a $20 bill, and a bit over 13 cents to print a $100 bill. It seems the Treasury could generate a nice profit for the government by simply printing currency and using this currency to purchase the goods and services the government needs. In fact, this seems to be a way to eliminate the problem of budget deficits for the U.S. government. Comment on this idea.

**117)** A famous American has been visiting the same tropical island for 15 years for vacations. When she goes she pays for everything by writing checks drawn on her U.S. bank. The currency the natives use is not U.S. dollars; they use a currency called a fungo. The natives never cash her checks. She is so well known on the island that the natives simply trade her checks among themselves. The question you need to answer, complete with an explanation, is: Who is paying for her vacation? (You can assume her bank would honor the checks if presented for payment even after a considerable period of time has passed.)

**Answer Key**Test name: Chapter 02 Test Bank

1) C

2) C

3) A

4) B

5) C

6) C

7) A

8) B

9) B

10) A

11) A

12) C

13) A

14) B

15) A

16) C

17) C

18) D

19) C

20) A

21) A

22) D

23) B

24) B

25) C

26) A

27) D

28) C

29) D

30) C

31) C

32) D

33) B

34) C

35) A

36) A

37) D

38) A

39) A

40) C

41) C

42) B

43) D

44) A

45) B

46) D

47) B

48) B

49) A

50) C

51) A

52) D

53) A

54) D

55) D

56) B

57) C

58) B

59) D

60) C

61) D

62) A

63) C

64) B

65) A

66) D

67) A

68) C

69) B

70) C

71) B

72) A

73) D

74) C

75) C

76) A

77) B

78) C

79) B

80) C

81) B

82) A

83) A

84) C

85) B

86) A

87) No, the residents of Country B will definitely spend more of their time transacting, trying to create a double coincidence of wants, and may have to rely on multiple trades to do so. They will also likely specialize less, reducing the gains to the country from specialization. In Country A the residents will be able to transact immediately using money, and will also be able to specialize in what they do well, creating a more efficient economy.

88) a. When there are 400 sand dollars and 200 fish purchased in a year, this implies that each fish costs 2 sand dollars (= 400/200).b. When the number of sand dollars increases to 500, the price of fish will increase to 2.5 sand dollars per fish (= 500/200). In order to prevent this inflation in fish prices, the number of fish would have to be increased to 250. That is, if there are 500 sand dollars and 250 fish, the price of fish would go back to 2 sand dollars per fish (= 500/250).

89) An asset is liquid when it can be converted into a means of payment, quickly, without suffering a loss in value.

90) Yes, but this is a good example of the high transaction costs that can occur in a barter economy due to the double coincidence of wants problem. Any one of the individuals will have to make two trades to get what they want; for example, the baker will have to trade bread with the orchard owner to get apples, to then be able to trade with the candy maker to obtain the chocolate that they really want.

91) The balances on the cards serve as both a means of payment and a store of value. Using the student ID card in this way is an example of a stored-value card, similar to a gift card for a store, or a card used to pay for public transportation. While these stored value cards are not included in the money supply, they are used as a means of payment and a store of value.

92) a.Cost of Market Basket in 2020 = 100(5) + 80(15) + 240(40) = 11,300Cost of Market Basket in 2021 = 150(5) + 80(15) + 300(40) = 13,950Cost of Market Basket in 2022 = 200(5) + 120(15) + 360(40) = 17,200b.CPI in 2020 = 100 since it is the base year.CPI in 2021 = 13,950/11,300 × 100 = 123CPI in 2022 = 17,200/11,300 × 100 = 152

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Year | Price of Good A | Price of Good B | Price of Good C | Cost of Market Basket | Consumer Price Index |
| 2020 | $100 | $80 | $240 | $11,300 | 100 |
| 2021 | $150 | $80 | $300 | $13,950 | 123 |
| 2022 | $200 | $120 | $360 | $17,200 | 152 |
|  |

93) Money is an asset because it represents something of value to the owner. But not all assets can be used as an immediate means of payment.

94) In an economy that does not rely on the use of money, if people are going to specialize at all they have to resort to barter, which is the exchange of one good or service for another. In the situation of barter, it may be likely that the individual who has what the other person wants will not want what the other person has. In this case multiple trades may be necessary to ultimately obtain what is desired. With the use of money, since everyone generally accepts it, one exchange will suffice. In reality you can say that money creates an immediate double coincidence of wants.

95) The general formula for the number of prices is *n* (*n* − 1)/2 where *n* = the number of goods. Since we have 100 people each producing one good, we have 100 goods, so *n* = 100. Plugging this into our formula, we obtain: 100(99)/2 = 4,950.Therefore, there will be 4,950 relative prices.

96) No; there are many assets that fall into the category of financial assets that are good stores of value, these include bonds and stocks. What distinguishes money is that it is liquid, meaning it can immediately serve as a means of payment. This is not true of other assets, which must be converted to spendable form. Moreover, it can be costly to turn a bond or stock into a means of payment, especially if it must be done on short notice.

97) Commodity money, such as gold or silver, has value even if it is not used as money. For example, gold coins could be melted down and converted to jewelry. Fiat money, such as U.S. paper currency, really has no value other than its use as money. Its value derives from the fact that it is deemed to be legal tender by the U.S. government, along with people's willingness to accept it.

98) While the Confederate government was printing this currency in increasing amounts, the prices in the South undoubtedly were rising. Any time currency is made increasingly available the eventual result will be higher prices. In addition, when the war ended and the Confederate states lost, the currency was basically worthless since there was no government that could guarantee its value. It was probably the case that as it was becoming clearer to people living in Confederate states that the outcome of the war was not going to be in their favor, it would not have been surprising if the people relied less on the currency and more on barter.

99) The check itself is never money; rather it is the balances on deposit that represent money. Therefore the $1,000 was money when it was in your checking account and that $1,000 will be money again when the Federal Reserve credits the reserve account of the bank receiving the check (and debits your bank's reserve account).

100) A credit card isn't money for a few reasons. One, it is not an asset. The use of a credit card actually creates a liability for the user. A credit card is a promise by a bank to lend the cardholder money with which to make purchases. The store supplying the goods being purchased receives money, but the money that is used does not belong to the buyer. The credit card provides the cardholder with access to someone else's money.

101) A debit card works the same way as a check, in that it provides the bank with instructions to transfer funds from the cardholder's account to the merchant's account. The debit cardholder must have adequate funds in their checking account to cover the purchase. A credit card is a promise by a bank to lend the cardholder money with which to make purchases. The store supplying the goods being purchased receives money, but the money that is used does not belong to the buyer, the credit card provides the cardholder with access to someone else's money.

102) Ranked from most liquid to least liquid: (1) currency; (2) checking account deposits; (3) savings accounts; (4) common Stock; (5) houses; (6) art.

103) The period 1990–2009. During the period 1960–1980, inflation often rose to more than 5 percent; during the period 1990–2000, it rarely did.

104) small denomination time deposits, plus savings deposits and money market deposit accounts and retail money market mutual fund shares

105) From 1960 to 1980 the growth rates of the two money measures did move together. After 1980 M1 behaved very differently than M2. The main reason for this seems to be the high rates of inflation that began in the late 1970s and fostered innovation into other types of accounts that people could hold to earn a higher return and yet were relatively liquid, such as money market accounts.

106) Empirical research mentioned in the chapter shows that across many countries, high rates of growth in M2 were associated with high rates of inflation and relatively low growth rates in M2 in many countries also were associated with low rates of inflation. For this reason many economists believe that, at least for moderate inflation rates, controlling inflation means controlling the money growth.

107) From 1960 to 1980 it seemed that the growth of M2 was a good tool to forecast inflation, with a two-year lag; in fact the correlation was over 0.5. For the years 1990 to 2016 this does not seem to be the case, in fact the correlation was 0. There is no clear explanation for why the growth of M2 has ceased being a good forecast tool for inflation, but there are some ideas economists are researching.

108) The CPI is measured using a fixed-expenditure-weight index. As a result, when the price of a good included in the index increases, the assumption is that people continue to purchase the same quantity of this item when in reality many consumers (to whatever degree possible) may stop purchasing this item and select a lower-priced substitute. This substitution toward a lower-priced good is not reflected in the reported CPI.

109) The CPI is designed to answer the following question: How much more would it cost for people to purchase today the same basket of goods and services they bought at some fixed time in the past? A CPI of 240 means that it takes $240 today to buy the market basket that cost $100 in the base year.

110) Substitution bias is an overstatement of inflation by the CPI that comes from the fact that the calculation of the index is based on the assumption of an unchanging market basket of goods and services. Since prices do not all rise at the same rate (and some may not rise or may even fall), people can avoid some inflation by changing their spending pattern, that is, substituting lower-priced goods in place of those whose prices have risen. In order to take this into account, the BLS now changes the weights used in the CPI every two years, and today's CPI is a much more accurate measure of inflation.

111) Investors began to doubt the value of a wide class of securities so market liquidity for those instruments disappeared and financial institutions that held them faced large losses. In turn, funding liquidity for these institutions dried up as the potential losses caused their lenders to be worried about their safety.

112) This is occurring because efficient payments systems continue to evolve and seek easier and cheaper ways to pay for things.

113) Payments would be far easier and efficient in Duos. With fewer goods to be traded, the likelihood of reaching a double coincidence of wants would be greater. Also, with fewer goods being produced, the need for specialization is not as great as it would be in Varietas. With 80 different goods, people in Varietas are likely to be specialized. Also, with many different goods, the need for information is much greater in Varietas. Duos would have one relative price, 1 = 2(2 − 1)/2. Varietas would have thousands of relative prices: 3,160 = 80(80 − 1)/2. This suggests that quoting prices and recording debts would be easier in Duos. Varietas would benefit more from adopting money, for the reasons cited above.

114) Historically, the United States adopted the use of gold as a currency (or as a way to back paper notes) because people had grown suspicious of the use of fiat money. During the Revolutionary War, the Continental Congress issued Continentals that became worthless with rising inflation. Using gold to back currency gave the public trust in the government's ability and desire to protect its value (e.g., to prevent rising inflation). Today, the currency printed by the United States Treasury Bureau of Engraving and Printing is fiat money. That is, it has little or no intrinsic value. The general public is willing to use this fiat money because it trusts the government's promise to protect its value. People have an expectation that they will be able to use the existing currency to pay for goods and services.

115) The Continental Congress issued continentals in 1775 to finance the Revolutionary War. The French Revolutionary Government issued assignats in 1793. The inflation rates during both historical episodes increased. The money supply is linked to the economy's inflation rate. As the money supply grows at a faster rate, the inflation rate rises.

116) At first it seems the Treasury could buy one hundred dollars’ worth of goods for an actual cost of less than fourteen cents, the cost of printing the note. Plus the Treasury can avoid having to borrow to finance the difference between tax receipts and expenditures. But what may be profitable for the Treasury can be very harmful to the economy. The printing of this additional currency can have many serious consequences. The additional currency will increase the money supply, which can fuel higher prices, lowering the real purchasing power of money. If the problem becomes large enough it can actually make people reluctant to accept the currency as a means of payment and they would revert to increased use of barter which can make the economy less efficient.

117) Obviously neither the famous American nor her bank is paying for the vacation since the checks are never presented for payment. On the other hand, the famous American is providing the people on the island with additional money, which they seem very comfortable using. As a result, the money supply on the island has increased by the amount of these checks. One result of the added money will be inflation, so islanders will see the real purchasing power of their money decrease, thus their loss in real purchasing power has been used to pay for the famous American's vacations.