

# EC1B5 | Chapter 11

## The Monetary System

### Additional Practice Questions:

#### **Book Question 2**

Money makes a variety of economic transactions possible. In the following three situations, determine whether money is involved in the transaction.

- a. On the island of Yap, exchanges were made by using large circular stone discs carved out of limestone. Since these stones were too large to move, when an exchange occurred, a stone stayed in its place but its ownership would change. Can these stone discs be termed as money?
- b. In recent years it has become increasingly common to pay with your smartphone. Is your smartphone money? Explain your reasoning.
- c. In food courts at several malls, it is quite common to use coupons instead of money. This means that you exchange your currency notes for coupons and use them to purchase meals. Can such coupons be considered money?

#### **Book Question 3**

In some parts of the world, salt—the stuff sitting on your kitchen table—was once used as currency. In ancient Ethiopia, for example, blocks of salt were used to purchase goods and pay salaries. The value of the salt block was based on weight, and it was physically transferred as part of the transaction. In part, salt was valuable because of its scarcity and its usefulness: before the introduction of refrigeration, many civilizations used salt to preserve food.

- a. Discuss how salt did or did not fulfill the three roles of currency.
- b. Suppose several new salt mines opened in ancient Ethiopia. How would you expect the rapid infusion of currency into society to affect the economy? Explain.
- c. How might the use of salt as a commodity affect the value of salt as money? As an example, would you need more or less salt to buy a pound of meat?

#### **Book Question 5**

Imagine that the central bank of the island economy you live in announced this morning that every denomination of the currency in circulation would be worth half of what it was yesterday. For example, a 20 Tutu bill would be worth 10 Tutus, the balances in all checking and savings accounts are to be halved, and so forth. Islanders panic as they think they became two times as poorer as they were yesterday, they are planning for the revolution to topple the system. Would you actually be two times poorer on the day the announcement took effect? Why or why not?

**Book Question 10**

Till the late nineteenth century, it was common for gold and silver coins to be used as a medium of exchange. When it required money, governments would often mint more coins and replace some quantities of the gold or silver with iron. What would be the effect of such a policy?

**Book Question 11**

As the U.S. economy recovers from the effects of the coronavirus recession, it is anticipated that the Fed will raise the federal funds rate. Suppose the current federal funds rate is 0 percent and that this rate is expected to prevail for 2 years. Then the expectation is that the Fed will raise the federal funds rate by 0.5 percentage points each year thereafter. What will be the 10-year nominal interest rate as a result of these expectations? Explain and show your work.