Assessments Chapter 4

1. What is fiat money primarily backed by?

A) Gold reserves

B) Silver reserves

C) Government decree

D) Foreign currency reserves

Correct Answer: C) Government decree

Rationale: Fiat money is not backed by physical commodities like gold or silver but by the government's declaration that it must be accepted as a form of payment.

2. Which event led to the end of the gold standard and the beginning of the fiat system?

A) Bretton Woods Agreement

B) Executive Order 6102

C) The Nixon Shock

D) The creation of the Federal Reserve

Correct Answer: C) The Nixon Shock

Rationale: The Nixon Shock in 1971 ended the convertibility of U.S. dollars to gold, marking the start of the fiat currency system.

3. What was the purpose of Executive Order 6102 issued in 1933?

A) To establish the Federal Reserve

B) To mandate the use of fiat currency

C) To confiscate private gold holdings

D) To create the Bretton Woods system

Correct Answer: C) To confiscate private gold holdings

Rationale: Executive Order 6102 required U.S. citizens to surrender their gold to the government, which was part of the shift away from gold-backed currency.

4. Why is fiat money considered more prone to inflation than commodity-backed money?

A) It is easier to produce

B) It is not tied to physical assets

C) It is controlled by the central bank

D) It is used worldwide

Correct Answer: B) It is not tied to physical assets

Rationale: Since fiat money is not backed by tangible assets, its value can be easily manipulated, leading to higher risks of inflation.

5. What does the term "fractional reserve banking" refer to?

A) Banks holding reserves equal to all deposits

B) Banks holding a fraction of deposits in reserve

C) Banks issuing loans only when fully backed by deposits

D) Banks using gold reserves to issue loans

Correct Answer: B) Banks holding a fraction of deposits in reserve

Rationale: Fractional reserve banking allows banks to keep only a portion of deposits as reserves while lending out the remainder.

6. What was one consequence of the Gold Reserve Act of 1934?

A) It allowed gold to be freely traded by citizens

B) It devalued the U.S. dollar by increasing the price of gold

C) It established the Federal Reserve as the central bank

D) It created the fiat currency system

Correct Answer: B) It devalued the U.S. dollar by increasing the price of gold

Rationale: The Gold Reserve Act devalued the dollar by raising the price of gold from $20.67 to $35 per ounce, reducing the purchasing power of the currency.

7. Which of the following is a disadvantage of the fiat money system?

A) Low inflation rates

B) Ease of use

C) Potential for abuse and manipulation

D) High production costs

Correct Answer: C) Potential for abuse and manipulation

Rationale: Fiat money can be manipulated by governments and central banks, which may lead to corruption and loss of trust.

8. How did fractional reserve banking contribute to the creation of money?

A) By keeping 100% of deposits as reserves

B) By lending out the entire amount of deposits

C) By lending out a portion of deposits, creating more money in the system

D) By using only gold-backed deposits for loans

Correct Answer: C) By lending out a portion of deposits, creating more money in the system

Rationale: Fractional reserve banking allows banks to lend out a portion of deposits, which effectively creates new money in the economy through the multiplier effect.

9. What is a central bank's role in the fiat money system?

A) To store gold reserves

B) To set the value of gold

C) To control the money supply and stabilize the economy

D) To issue bonds

Correct Answer: C) To control the money supply and stabilize the economy

Rationale: Central banks manage the fiat money supply and intervene to prevent economic instability, such as bank failures.

10. Which agreement established the U.S. dollar as the world’s reserve currency?

A) The Bretton Woods Agreement

B) The Federal Reserve Act

C) The Gold Reserve Act

D) The Nixon Shock

Correct Answer: A) The Bretton Woods Agreement

Rationale: The Bretton Woods Agreement in 1944 established the U.S. dollar as the dominant global reserve currency.

11. What was the main reason for the creation of the Federal Reserve in 1913?

A) To transition to fiat currency

B) To provide a lender of last resort to banks

C) To regulate the stock market

D) To manage the national gold reserves

Correct Answer: B) To provide a lender of last resort to banks

Rationale: The Federal Reserve was established to stabilize the banking system by acting as a lender of last resort during financial crises.

12. Why did the value of gold rise significantly in the 1970s?

A) Increased mining activities

B) The end of the gold standard

C) Reduced demand for fiat currency

D) Global economic growth

Correct Answer: B) The end of the gold standard

Rationale: After the U.S. ended the dollar's convertibility to gold, the value of gold surged as it was no longer tied to a fixed price by the government.

13. What does the term "legal tender law" mean?

A) A law making it obligatory for all citizens to hold gold

B) A law that sets the price of gold

C) A law requiring all citizens to accept a specific kind of currency

D) A law regulating international trade

Correct Answer: C) A law requiring all citizens to accept a specific kind of currency

Rationale: Legal tender laws mandate that a certain currency must be accepted for the payment of debts and transactions.

14. What is the primary risk associated with fractional reserve banking?

A) Banks holding too much in reserve

B) Inflation due to the creation of excess money

C) Deflation due to limited lending

D) Currency appreciation

Correct Answer: B) Inflation due to the creation of excess money

Rationale: Fractional reserve banking can lead to inflation as banks create more money through lending, increasing the money supply.

15. What economic effect does the central bank's intervention during a banking crisis typically have?

A) Decreases money supply

B) Increases bank reserves

C) Reduces inflation rates

D) Lowers interest rates permanently

Correct Answer: B) Increases bank reserves

Rationale: Central banks intervene by injecting new currency or buying assets to increase bank reserves, preventing failures and stabilizing the economy.