Chapter 02
International Monetary System

Multiple Choice Questions

1. The international monetary system can be defined as the institutional framework within which
A. international payments are made.
B. movement of capital is accommodated.
C. exchange rates among currencies are determined.
D. all of the above

2. Corporations today are operating in an environment in which exchange rate changes may adversely affect their competitive positions in the marketplace. This situation, in turn, makes it necessary for many firms to
A. carefully manage their exchange risk exposure.
B. carefully measure their exchange risk exposure.
C. both a) and b)

3. The international monetary system went through several distinct stages of evolution. These stages are summarized, in alphabetic order, as follows:

(i)- Bimetallism
(ii)- Bretton Woods system
(iii)- Classical gold standard
(iv)- Flexible exchange rate regime
(v)- Interwar period

The chronological order that they actually occurred is:
A. (iii), (i), (iv), (ii), and (v)
B. (i), (iii), (v), (ii), and (iv)
C. (vi), (i), (iii), (ii), and (v)
D. (v), (ii), (i), (iii), and (iv)

4. In the United States, bimetallism was adopted by the Coinage Act of 1792 and remained a legal standard until 1873,
A. when Congress dropped the silver dollar from the list of coins to be minted.
B. when Congress dropped the twenty-dollar gold piece from the list of coins to be minted.
C. when gold from the California gold rush drove silver out of circulation.
D. when gold from the California gold rush drove gold out of circulation.

5. The monetary system of bimetallism is unstable. Due to the fluctuation of the commercial value of the metals,
A. the metal with a commercial value lower than the currency value tends to be used as metal and is withdrawn from circulation as money (Gresham's Law).
B. the metal with a commercial value higher than the currency value tends to be used as money (Gresham's Law).
C. the metal with a commercial value higher than the currency value tends to be used as metal and is withdrawn from circulation as money (Gresham's Law).
D. none of the above

6. In the 1850s the French franc was valued by both gold and silver, under the official French ratio which equated a gold franc to a silver franc 15½ times as heavy. At the same time, the gold from newly discovered mines in California poured into the market, depressing the value of gold. As a result,
A. the franc effectively became a silver currency.
B. the franc effectively became a gold currency.
C. silver became overvalued under the French official ratio.
D. answers a) and c) are correct

7. Gresham's Law states that
A. bad money drives good money out of circulation.
B. good money drives bad money out of circulation.
C. if a country bases its currency on both gold and silver, at an official exchange rate, it will be the more valuable of the two metals that circulate.
D. none of the above.

8. Suppose that the pound is pegged to gold at £20 per ounce and the dollar is pegged to gold at $35 per ounce. This implies an exchange rate of $1.75 per pound. If the current market exchange rate is $1.80 per pound, how would you take advantage of this situation? *Hint: assume that you have $350 available for investment.*
A. Start with $350. Buy 10 ounces of gold with dollars at $35 per ounce. Convert the gold to £200 at £20 per ounce. Exchange the £200 for dollars at the current rate of $1.80 per pound to get $360.
B. Start with $350. Exchange the dollars for pounds at the current rate of $1.80 per pound. Buy gold with pounds at £20 per ounce. Convert the gold to dollars at $35 per ounce.
C. a) and b) both work
D. None of the above

9. Suppose that the pound is pegged to gold at £20 per ounce and the dollar is pegged to gold at $35 per ounce. This implies an exchange rate of $1.75 per pound. If the current market exchange rate is $1.60 per pound, how would you take advantage of this situation? *Hint: assume that you have $350 available for investment.*
A. Start with $350. Buy 10 ounces of gold with dollars at $35 per ounce. Convert the gold to £200 at £20 per ounce. Exchange the £200 for dollars at the current rate of $1.80 per pound to get $360.
B. Start with $350. Exchange the dollars for pounds at the current rate of $1.60 per pound. Buy gold with pounds at £20 per ounce. Convert the gold to dollars at $35 per ounce.
C. a) and b) both work
D. None of the above

10. Suppose that the United States is on a bimetallic standard at $30 to one ounce of gold and $2 for one ounce of silver. If new silver mines open and flood the market with silver,
A. only the silver currency will circulate.
B. only the gold currency will circulate.
C. no change will take place since citizens could exchange their gold currency for silver currency at any time.
D. none of the above

11. Suppose that your country officially defines gold as ten times more valuable than silver (i.e. the central bank stands ready to redeem the currency in gold and silver and the official price of gold is ten times the official price of silver). If the market price of gold is only eight times as much as silver.
A. The central bank could go broke if enough arbitrageurs attempt to take advantage of the pricing disparity.
B. The central bank will make money since they are overpricing gold.

12. Prior to the 1870s, both gold and silver were used as international means of payment and the exchange rates among currencies were determined by either their gold or silver contents. Suppose that the dollar was pegged to gold at $30 per ounce, the French franc is pegged to gold at 90 francs per ounce and to silver at 9 francs per ounce of silver, and the German mark pegged to silver at 1 mark per ounce of silver. What would the exchange rate between the U.S. dollar and German mark be under this system?
A. 1 German mark = $2
B. 1 German mark = $0.50
C. 1 German mark = $3
D. 1 German mark = $1

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14. Suppose that country A and country B are both on a bimetallic standard. In country A the ratio is 15 to one (i.e. an ounce of gold is worth 15 times as much as an ounce of silver in that currency), while in country B the ratio is ten to one. If the free flow of capital is allowed between countries A and B is this a sustainable framework?
A. Yes
B. No
C. There is not enough information to make an informed determination.

15. Suppose that both gold and silver are used as international means of payment and the exchange rates among currencies are determined by either their gold or silver contents. Suppose that the dollar was pegged to gold at $20 per ounce, the Japanese yen is pegged to gold at 120,000 yen per ounce and to silver at 8,000 yen per ounce of silver, and the Australian dollar is pegged to silver at $5 per ounce of silver. What would the exchange rate between the U.S. dollar and Australian dollar be under this system?
A. $1 U.S. = $1 Australian
B. $1 U.S. = $2 Australian
C. $1 U.S. = $3 Australian
D. None of the above

16. The United States adopted the gold standard in
A. 1776.
B. 1879.
C. 1864.
D. 1973.

17. The gold standard still has ardent supporters who believe that it provides
A. an effective hedge against price inflation.
B. fixed exchange rates between all currencies.
C. monetary policy autonomy.
D. all of the above

18. One potential drawback of the gold standard is that
A. the world economy can be subject to deflationary pressure due to the limited supply of monetary gold.
B. the world economy can be subject to inflationary pressure without changes in the supply of monetary gold.
C. gold is scarce.
D. all of the above

19. The first full-fledged gold standard
A. was not established until 1821 in Great Britain, when notes from the Bank of England were made fully redeemable for gold.
B. was not established until 1780 in the United States, when notes from the Continental Army were made fully redeemable for gold.
C. was established in 986 during the Han dynasty in China.
D. none of the above

20. An "international" gold standard can be said to exist when
A. gold alone is assured of unrestricted coinage.
B. there is two-way convertibility between gold and national currencies at stable ratios.
C. gold may be freely exported or imported.
D. all of the above

21. Under a gold standard, if Britain exported more to France than France exported to Great Britain,
A. such international imbalances of payment will be corrected automatically.
B. this type of imbalance will not be able to persist indefinitely.
C. net export from Britain will be accompanied by a net flow of gold in the opposite direction.
D. all of the above

22. Suppose that Britain pegs the pound to gold at six pounds per ounce, whereas the exchange rate between pounds and U.S. dollars is $5 = £1. What should an ounce of gold be worth in U.S. dollars?
A. $29.40
B. $30.00
C. $0.83
D. $1.20

23. During the period of the classical gold standard (1875-1914) there were
A. highly volatile exchange rates.
B. volatile exchange rates.
C. moderately volatile exchange rates.
D. stable exchange rates.
E. no exchange rates.

24. The majority of countries got off gold in 1914 when
A. the American Civil War ended.
B. World War I broke out.
C. World War II started.
D. none of the above

25. Suppose that the British pound is pegged to gold at £6 per ounce, whereas one ounce of gold is worth €12. Under the gold standard, any misalignment of the exchange rate will be automatically corrected by cross border flows of gold. Calculate the possible gains for buying €1,000, if the British pound becomes undervalued and trades for €1.80. (Assume zero shipping costs).
(Hint: Gold is first purchased using the devalued British pound from the Bank of England, then shipped to France and sold for €1,000 to the Bank of France).
A. £55.56
B. £65.56
C. £75.56
D. £85.56

26. Suppose that Britain pegs the pound to gold at the market price of £6 per ounce, and the United States pegs the dollar to gold at the market price of $36 per ounce. If the official exchange rate between pounds and U.S. dollars is $5 = £1. Which of the following trades is profitable?
A. Start with £100 and trade for $500 at the official exchange rate. Redeem the $500 for 13.89 ounces of gold. Trade the gold for £83.33.
B. Start with $100 and buy gold. Sell the gold for £16.67. Sell the pounds at the official exchange rate.
C. Start with £100 and buy gold. Sell the gold for $600.
D. Start with $500 and trade for £100 at the official exchange rate. Redeem the £100 for 16 2/3 ounces of gold. Trade the gold for $600.

27. Assume that a country is on the gold standard. In order to support unrestricted convertibility into gold, banknotes need to be backed by a gold reserve of some minimum stated ratio. In addition,
A. the domestic money stock should rise and fall as gold flows in and out of the country.
B. the central bank can control the money supply by buying or selling the foreign currencies.
C. Both a) and b)

28. Under the gold standard, international imbalances of payment will be corrected automatically under the
A. Gresham Exchange Rate regime.
B. European Monetary System.
C. Price-specie-flow mechanism.
D. Bretton Woods Accord.

29. During the period between World War I and World War II,
A. the major European powers and the U.S. returned to the gold standard and fixed exchange rates.
B. while most countries abandoned the gold standard during World War I, international trade and investment flourished during the interwar period under a coherent international monetary system.
C. the U.S. dollar emerged as the dominant world currency, gradually replacing the British pound for the role.
D. None of the above.

30. During the period between World War I and World War II, many central banks followed a policy of *sterilization of gold*
A. by restricting the rate of growth in the supply of gold.
B. by matching inflows and outflows of gold respectively with reductions and increases in domestic money and credit.
C. by matching inflows and outflows of gold respectively with increases and reductions in domestic money and credit.
D. none of the above.

31. The price-specie-flow mechanism will work only if governments are willing to play by the rules of the game by letting the money stock rise and fall as gold flows in and out. Once the government demonetizes (neutralizes) gold, the mechanism will break down. In addition, the effectiveness of the mechanism depends on
A. the income elasticity of the demand for imports.
B. the price elasticity of the demand for imports.
C. the price elasticity of the supply of imports.
D. the income elasticity of the supply of imports.

32. During the period between World War I and World War II, the political reality was characterized by
A. halfhearted attempts and failure to restore the gold standard.
B. political instabilities and bank failures.
C. panicky flights of capital across borders.
D. all of the above

33. At the outbreak of World War I
A. major countries such as Great Britain, France, Germany and Russia suspended redemption of banknotes in gold.
B. major countries such as Great Britain, France, Germany and Russia imposed embargoes on the export of gold.
C. the classical gold standard was abandoned.
D. all of the above

34. The core of the Bretton Woods system was the
A. World Bank.
B. IMF.
C. United Nations.
D. Interstate Commerce Commission.

35. The Bretton Woods system was named after
A. the treasury secretary of the United States in 1945, Bretton Woods.
B. Bretton Woods, New Hampshire, where the Articles of Agreement of the International Monetary Fund (IMF) were hammered out.
C. none of the above.

36. The Bretton Woods agreement resulted in the creation of
A. the *bancor* as an international reserve asset.
B. the World Bank.
C. the Eximbank.
D. the Federal Reserve Bank.

37. The Triffin paradox
A. was first proposed by Professor Robert Triffin.
B. warned that the gold-exchange system of the Bretton Woods agreement was programmed to collapse in the long run.
C. was indeed responsible for the eventual collapse of the dollar-based gold-exchange system in the early 1970s.
D. all of the above are correct

38. Under the Bretton Woods system
A. there was an explicit set of rules about the conduct of international monetary policies.
B. each country was responsible for maintaining its exchange rate within 1 percent of the adopted par value by buying or selling foreign exchanges as necessary.
C. the U.S. dollar was the only currency that was fully convertible to gold.
D. all of the above