MONEY AND SPENDING (Chapter 12)

The Quantity Theory of Money

_____1. The quantity theory of money claims that the main determinant of the amount of money that is spent is the amount of money that
a. exists
b. is owed
c. was spent in the year before
d. all of the above

_____2. The quantity theory of money holds that $M \times V = D$, where M is the quantity of money in existence, V is the average number of times a unit of money is spent, and D is the amount of money spent.

_____3. In the quantity theory-of-money equation, D is usually to be understood as the aggregate demand (amount of spending) specifically for consumers' goods, i.e., as D_C.

_____4. In the quantity-theory-of-money equation, V is usually to be understood as the average number of times a unit of the money supply is spent specifically in buying consumers' goods, i.e., as "consumption velocity" or "income velocity."

_____5.
a. GDP is essentially the sum of consumption spending (private and government) plus gross investment
b. Since approximately 85 to 90 percent of GDP consists of consumer spending, the quantity-theory-of-money equation can be understood as providing an approximate expression of nominal, i.e., current-dollar GDP
c. both (a) and (b)
d. neither (a) nor (b)

_____6. In 2001, nominal GDP was reported as approximately $10.2 trillion. If the money supply is taken as $2.5 trillion, calculate velocity.

_____7.
a. The money supply is essentially the sum of currency in circulation outside the banking system plus checking deposits
b. Until 1994, the money supply was accurately reported in the statistic known as M_1. Currently, the money supply can best be measured by taking the sum of M_1 plus accumulated sweep accounts plus retail money market mutual fund accounts
c. both (a) and (b)
d. neither (a) nor (b)

_____8.
a. Different magnitudes of aggregate spending require different measures of velocity
b. The aggregate demand for consumers' goods and GDP are related to the money supply via "consumption velocity" or "income velocity."
c. Aggregate spending of all kinds, including for stocks, bonds, and real estate is related to the money supply via the concept of "transactions velocity."
d. all of the above

_____9. An increase in the quantity of money operates to raise the volume of spending in the economic system to a higher annual level simply by being spent and respent so long as it is in existence.

_____10. Where P is the general consumer price level, D_C is the aggregate demand (spending) for consumers' goods, and S_C is the aggregate supply of consumers' goods produced and sold, the general consumer price level equals D_C/S_C.

_____11. Calculate the effect on the general consumer price level if the quantity of money and the aggregate demand for consumers' goods increase by 4% over the course of a year while aggregate production and supply increase by 2%.

_____12. If the situation described in the preceding question were to be repeated year after year, how long would it take for the general consumer price level to double?

_____13. How long would it take the general consumer price level to double if the annual increase in the quantity of money and volume of spending were 10% while the annual increase in production and supply were 2%?

_____14. Increases in prices occur insofar as the increase in the quantity of money and volume of spending outstrips the increase in production and supply.

_____15.
a. A commodity money is one in which the monetary unit is a quantity of a physical commodity
b. Historically, gold and silver are the leading examples of commodity monies
c. All money begins as a commodity money
d. Paper money originates as a secure, transferable claim to commodity money payable on demand by the issuer
e. all of the above

_____16. Paper money which is not redeemable in commodity money is known as "fiat money."

_____17. The concept of paper money excludes checkbook money.

_____18.
a. A major difference between commodity money and fiat money concerns their potential rates of increase.
b. Specifically, the rate of increase of a gold or silver commodity money is almost certain to be relatively small because of the comparative rarity of these elements in nature and because increases

in their production and supply depend on costly mining operations
c. On the other hand, the rate of increase in a fiat money is potentially limitless, since there is no significant rarity of the necessary elements in nature and the process of increase is virtually costless
d. all of the above
e. none of the above

_____19. Assume that over a generation the quantity of money and volume of spending increase tenfold, while production and supply double. How great is the percentage rise in the general consumer price level?

_____20.
a. The formula for the general consumer price level shows demand as a numerator and supply as a denominator
b. In the light of this formula, it is simply inconceivable that prices could rise without demand rising or supply falling, or both
c. both (a) and (b)
d. neither (a) nor (b)

_____21. It is no more likely for prices to rise under a system of fiat paper money than under a system of commodity (i.e. gold or gold and silver) money.

_____22. Gold and silver moneys were often accompanied by long periods of falling prices, as in the generation preceding the discovery of the California gold fields and the generation from 1873–1896.

Origin and Evolution of Money and the Contemporary Monetary System

_____23. The essential condition that must be present in order for a barter exchange to take place is the existence of a double coincidence of wants, i.e., a state of affairs in which each of two parties possesses a good that the other desires and values the good in the possession of the other above the good he possesses and that the other desires.

_____24. In the absence of a double coincidence of wants, some of our more intelligent ancestors began to resort to indirect exchanges.

_____25.
a. An indirect exchange is one in which an individual exchanges his good or service for a good which he himself does not desire to consume or to use in production but rather as a means of making a further exchange
b. An indirect exchange is resorted to in cases in which a double coincidence of wants is lacking and it occurs to someone to exchange the good he has for something that he himself may not want but which the other party wants, i.e., the party who has the good our man wants
c. Goods that are sought for the purpose of being reexchanged are called media of exchange
d. all of the above
e. none of the above

_____26.
a. Before a good can be used as a medium of exchange, it must have a recognized value as an ordinary commodity
b. Goods that are more widely and more frequently desired as ordinary commodities have a greater likelihood of becoming media of exchange than goods that are less widely and less frequently desired as ordinary commodities
c. In the course of history, numerous goods have served as media of exchange
d. all of the above

_____27.
a. A generally accepted medium of exchange constitutes money
b. The process of a medium of exchange developing into money is cumulative and self-reinforcing
c. The use of a good as a medium of exchange represents an additional source of demand for it and operates to raise its value, thereby reducing the extent to which it is used for its ordinary, commodity purposes
d. all of the above

_____28. In some parts of Europe in the mid 1940s cigarettes developed into a kind of quasi-money. In the process non-smokers became eager to accept cigarettes in exchange for their goods and smokers reduced their smoking because of the resulting higher value of cigarettes.

_____29. Historically, gold and silver in particular came to be money as civilization developed. This was because
a. In an environment of fixed settlements, the precious metals are the most suitable physical commodities for most people to save
b. The growing use of gold and silver as a store of value set the stage for their use as media of exchange
c. The growing use of gold and silver as media of exchange added relative stability to their value and thus favored their use as a medium in which to write contracts and state debts
d. The making of contracts payable in gold or silver reinforced the use of gold and silver as media of exchange by creating a class of people needing to obtain them to meet their contractual obligations
e. all of the above

_____30. Paper currency and checkbook money
a. came into existence as secure claims, payable on demand, in gold or silver coin and could not have come into existence without being a claim to a preexisting, commodity money
b. In establishing a uniform, gold-backed paper currency, that people could regard as “as good as gold,” the National Bank Act of 1863 played a

critical role in fostering the use of paper money in the United States in place of gold coin
c. By the outbreak of World War I, two generations of experience with the day-to-day use of paper money and virtual disappearance of gold coin from circulation had created the potential for paper money to be acceptable even without redeemability into gold
d. all of the above

_____31. The great bulk of the American people's gold came into the governments hands
a. in World War I, as the result of a wartime amendment to the Federal Reserve Act of 1913
b. in 1933, when the New Deal ordered all privately held monetary gold to be turned into the Federal government

_____32. The Federal Reserve's possession of the gold previously held by the private banking system made possible a substantial increase in the supply of dollars by virtue of a pyramiding of the gold reserves.

_____33. After 1933 people continued to accept paper dollars, even though they were no longer redeemable in gold, because the paper dollars had acquired a history of acceptability, in which everyone's experience taught that paper dollars were and would continue to be generally acceptable and led virtually everyone to be willing to go on accepting them.

_____34. Even though after 1933 the law required the Federal Reserve to hold substantial gold reserves against the dollars it created, for many years this requirement did not impose an effective limit on the Fed's ability to increase the supply of dollars because of its possession of substantial excess gold reserves.

_____35. Excess gold reserves are gold reserves held in excess of the gold reserves legally required to be held.

_____36. From 1935 to the end of World War II, the Fed possessed large and growing excess gold reserves
a. as the result of the rise in the official price of gold from $20.67 per ounce to $35 per ounce
b. as the result of the influx of large amounts of gold from the rest of the world, especially Western Europe
c. both (a) and (b)

_____37. The excess gold reserves of the Fed were gradually eliminated in the twenty years following World War II in the attempt to hold the world price of gold at $35 per ounce.

_____38. In 1965, as the exhaustion of the Fed's excess gold reserves threatened, Congress abolished the Fed's gold reserve requirements.

_____39. Abandonment of external convertibility of the dollar at the rate of $35 per ounce was not inevitable, despite the fact that its maintenance in the face of rising prices for almost everything other than gold served to make gold cheaper and cheaper relative to almost everything else and had to create an ever rising industrial demand for gold.

_____40. The potential for a spontaneous remonetization of gold
a. is created under conditions of substantial inflation, in which there is a growing use of gold as an inflation hedge
b. Would be greatly increased if it were legal for businessmen to discriminate between precious metal coins and paper currency of the same face value
c. both (a) and (b)
d. neither (a) nor (b)

_____41. "Fiduciary media"
a. are transferable claims to standard money, redeemable by the issuer on demand, and accepted in commerce as the equivalent of standard money, but for which no standard money actually exists
b. are backed by debt
c. create the potential for a deflation of the money supply because of bankruptcies of business firms that are indebted to banks and consequent bank failures
d. represent the far greater part of the present-day money supply
e. the process of their being wiped out played a major role in the great depression of the 1930s
f. all of the above

_____42. Standard money
a. unlike, fiduciary media, is not a claim to anything further but has ultimate, final debt-paying power
b. under a gold standard is gold coin or bullion
c. at the present time consists of irredeemable paper dollars
d. all of the above

_____43. The "monetary base"
a. is the sum of currency in circulation outside the banks plus the checking deposits of the Federal Reserve system
b. represents the supply of standard money
c. both (a) and (b)

_____44. Fiduciary media come into existence
a. when a bank lends out currency that has been deposited with it in a checking account
b. when a bank creates and lends out a new and additional checking deposit on the basis of the currency or other reserves that it has obtained through its receipt of a checking deposit
c. both (a) and (b)
d. neither (a) nor (b)

_____45. The checking deposits of a bank can be viewed
a. as fully covered up to the limit of the bank's standard money reserves and then as totally uncov-

ered to the extent that the deposits exceed the bank's standard money reserves
b. as uniformly partially covered by a fractional reserve to the extent that the bank has standard money reserves
c. both (a) and (b)

_____46. The opposite system of fiduciary media is the 100 percent reserve system.

_____47. Under the 100 percent reserve principle, checking deposits and banknotes are 100 percent backed by standard money.

_____48. The 100 percent reserve principle applies only to checking deposits and banknotes, i.e., only to actually spendable money, not to savings deposits or time deposits, which cannot be spent until they are withdrawn.

_____49. Under fractional reserve banking, paper currency and banknotes are backed only fractionally by standard money and for the rest by debt.

_____50. Fractional-reserve demand deposits possess a *deflationary* potential that,
a. once unleashed, tends to be self-reinforcing and cumulative, ultimately capable of wiping out all fiduciary media
b. was unleashed during the 1929 depression
c. to be avoided, requires the government's ability to create large sums of new and additional standard money to whatever extent may be necessary to assure the redeemability of all or most outstanding fiduciary media
d. all of the above

_____51. A 100 percent reserve monetary system would make the money supply absolutely independent of the failure of any debtors and thus make sudden, drastic reductions in the money supply virtually impossible.

_____52. In a banking system that was free of government interference, the creation of fiduciary media would be greatly limited by
a. the loss of reserves by banks creating fiduciary media to banks that were not creating fiduciary media or not creating them as rapidly
b. the loss of reserves by the whole banking system as the result of the public's need to increase its holding of currency as the overall supply of money increased
c. both (a) and (b)

_____53. Over the course of many years, government policy has promoted fractional reserve banking by means of
a. increasing the supply of standard money, with the effect both of reducing or preventing clearing losses by expanding banks and of meeting the public's growing demand for currency holdings, in both ways reducing or preventing the loss of reserves as the banks expanded the supply of fiduciary media
b. central bank rediscounting of commercial bank assets, thereby encouraging the commercial banks to hold assets other than standard money as a source of reserves when necessary
c. imposing deposit insurance and bank examinations, thereby increasing the public confidence's in the banking system and permitting the banks to operate with a lower level of reserves than would otherwise have been necessary
d. permitting temporary suspensions of payments by the banks to their depositors, thereby enabling the banks to hold a lower level of reserves than would have been necessary to avoid suspensions of payments
e. all of the above

_____54. Short of prohibiting fiduciary media, the government could greatly reduce their issuance simply by means of doing nothing that encourages their issuance.

_____55. President Andrew Jackson's specie circular represented a refusal by the government to accept fiduciary media in the payment of taxes.

_____56. The Federal Reserve's "open-market operation"
a. is its buying and selling of securities, typically of the US government, in the open market, with the effect of increasing or decreasing the standard money reserves of the banking system and the public's holdings of currency
b. operates substantially more on the side of buying than on the side of selling
c. is the principal mechanism by means of which it puts new and additional standard money into the economic system, since it buys securities with money that it itself creates
d. is the mechanism by means of which government budget deficits are financed by the creation of new and additional standard money.
e. all of the above

_____57. The demand for money for holding reflects the need and desire of people to hold money.

_____58. A rise in the demand for money for holding is the cause of a rise in the velocity of circulation of money and its fall is the cause of a fall in the velocity of circulation of money.

_____59. The demand for money for holding declines and as
a. the security of property improves
b. financial markets and financial institutions develop
c. improvements in transportation and the development of clearing houses occur
d. all of the above

_____60. As the security of property declines

a. the demand for precious-metal money for holding rises
b. the demand for fiat paper money for holding declines
c. both (a) and (b)

_____61. The fact that the demand for money for holding declines and thus velocity rises as the result of economic improvements such as greater security of property and the development of financial markets and financial institutions means that these developments have an inflationary effect in that in raising velocity they raise the demand for consumers' goods and thus the prices of consumers' goods.

_____62. When the demand for money for holding declines as the result of economic improvements such as greater security of property and the development of financial markets and financial institutions, the resulting rise in velocity is largely in the form of total transactions velocity rather than income or consumption velocity, because the same improvements entail the development of greater division of labor and thus more buying and selling at stages other than the sale of consumers' goods. At the same time, these improvements serve to increase the production and supply of consumers' goods.

_____63. In the context of an economic system with developed financial institutions and financial markets,
a. funds that are saved are put back into the spending stream almost immediately, while funds that are held for consumption may not be spent until the consumption purchases they are held for actually take place
b. the effect of saving is to increase the availability of credit, which represents an important substitute for the holding of cash
c. *saving* operates to raise the income velocity of money, by virtue of (a) and (b)
d. all of the above

_____64. In the conditions in which the velocity of circulation of a gold money rises, there is unlikely to be any fall in the purchasing power of gold as a result.

_____65. The more rapidly the quantity of money increases, the less will be the demand for money for holding and thus the greater will be the velocity of circulation of money, including income velocity.

_____66. The reason that the more rapidly the quantity of money increases, the more the demand for money for holding declines is that
a. the more rapidly do prices rise and the more it appears advantageous to reduce cash holdings in order to buy sooner rather than later
b. the easier it becomes to profitably liquidate inventories and other noncash assets, with the result that the holding of such assets appears to be a better source of cash in the future than the holding of actual cash, and thus takes the place of the holding of cash
c. the higher, after a time, do interest rates tend to be, with the result that it becomes worthwhile to lend out progressively smaller and shorter-term sums that otherwise would have been retained in cash holdings
d. to the extent that the increase is in the form of credit expansion (i.e., the creation of new and additional money for the purpose of being lent out), the easier and more profitable it becomes to substitute the prospect of obtaining credit for the holding of cash
e. all of the above

_____67. Increases in the quantity of money that take place in the form of credit expansion, i.e., are used to finance the granting of new and additional loans,
a. initially serve to reduce the rate of interest
b. when absorbed into the spending stream serve to raise sales revenues, profit margins, and the rate of profit, and thereby to increase the demand for loanable funds and to reduce the supply of loanable funds, with the result that the rate of interest now tends to rise to reflect the higher rate of profit
c. both (a) and (b)

_____68. Once the increase in the quantity of money created by credit expansion becomes absorbed into the spending stream, the only way to prevent interest rates from rising is by accelerating the increase in the quantity of money, which then makes the rate of profit rise still higher and further increases the demand for loanable funds and reduces the supply of loanable funds, requiring a still further acceleration in the rate of increase in the money supply if the rate of interest is not to rise. Thus to avoid rapid destruction of the monetary system, there is no practical alternative but to allow the rate of interest to follow the rate of profit on up as the quantity of money increases.

_____69. Interest is the price of money. Thus, the larger the money supply, the lower must be the rate of interest.

_____70. Interest is
a. the price of money
b. the difference between the sum of money borrowed and the larger sum that must be repaid

_____71. The changes in the velocity of circulation of money in the period 1929–1945 are inconsistent with a positive relationship between velocity and changes in the quantity of money.

_____72. The changes in the velocity of circulation of money in the period 1946–1981 are inconsistent with a positive relationship between velocity and changes in the quantity of money.

_____73. The changes in the velocity of circulation of money in the period 1981 to the present are in-

consistent with a positive relationship between velocity and changes in the quantity of money.

_____74. The present monetary system has the potential both for major inflation and for major deflation.

The Balance of Trade and Payments

_____75. The "balance of trade" is
a. the difference between the sum of all of a country's exports and the sum of all of its imports
b. typically described as favorable to the extent that its exports exceed its imports and unfavorable to the extent that its imports exceed its exports
c. both (a) and (b)

_____76. The "balance of payments" is
a. a broader concept than the balance of trade, being the difference between the sum of *all* of a country's receipts from abroad and *all* of its outlays to abroad
b. typically described as favorable to the extent that its outlays to abroad exceed its receipts from abroad and unfavorable to the extent that its receipts from abroad exceed its outlays to abroad
c. both (a) and (b)

_____77. The doctrines of the balance of trade and the balance of payments imply international economic conflict, since they imply that each country should seek a "favorable" balance that in the nature of the case must be regarded as "unfavorable" to other countries and thus that an implicit goal of every country is the infliction of harm on other countries.

_____78. The doctrines of the balance of trade and the balance of payments were first propounded by
a. the Classical economists
b. the Mercantilists
c. the Physiocrats

_____79. So long as the only significant international economic dealings were in the form of imports and exports, the concepts of the balance of trade and the balance of payments could be taken as interchangeable.

_____80. When the doctrines of the balance of trade and balance of payments originated
a. gold and silver were money
b. most European countries had no significant gold or silver mines within their borders
c. an excess of exports over imports was sought as the means of accumulating "treasure" within a country, which could later be used for financing foreign military ventures
d. an excess of exports over imports was the means for achieving an increase in the quantity of money in such countries
e. an excess of exports over imports came to be considered favorable for all the reasons that people believe an increase in the quantity of money is favorable
f. all of the above

_____81. In the eyes of the supporters of the balance of trade/payments doctrines, the individual items in the balances are all essentially separate and independent of one another, with the result that the overall balance is regarded as essentially fortuitous, capable of being "harmed" by anything that would enlarge this or that import or other category of outlay or reduce this or that export or other category of receipt, and "improved" by anything that would enlarge this or that export or other category of receipt or reduce this or that import or other category of outlay.

_____82. In the eyes of the supporters of the balance of trade/payments doctrines, each export or receipt from abroad constitutes an equivalent addition to the money supply of a country, while each import or other outlay to abroad constitutes an equivalent subtraction from the money supply of a country.

_____83. In the eyes of the supporters of the balance of trade/payments doctrines, in the absence of government intervention to prevent it, imports and other outlays to abroad have the potential of completely draining a country of its money supply.

_____84. Concern with an unfavorable balance of trade or payments under a gold standard may have some plausibility, but under the conditions of a fiat paper money, in which any part of the money supply that might be lost to abroad can easily be replaced by means of printing more money, it makes no sense whatever.

_____85. To some extent the position of the dollar as an international money entails some actual loss of dollars to abroad each year, but such loss,
a. far from being a proper source of worry, simply represents a modest lessening of the degree of domestic inflation of the money supply
b. is analogous to the loss of gold experienced every year by a gold-producing country, such as South Africa, with the difference that the paper money that is exported costs next to nothing to produce
c. both (a) and (b)

_____86. The far greater part of what is recorded as an unfavorable balance of payments represents
a. an actual outflow of money
b. an increase in short-term foreign lending to the citizens of the country, or to its government, the proceeds of which are not counted on the receipts side because they are short term

_____87. Insofar as it represents short-term foreign lending to a country's citizens or its government, the actual significance of an "unfavorable balance of payments" is favorable, because it represents capital investment in the country and/or a mitigation of the consequences of its government's borrowing.

_____88. The various items in the balance of payments accounts are not independent, but rather are mutually interconnected. For example, the so-called unfavorable balance of trade (the excess of imports over exports) that the United States has experienced in recent years is precisely the result of the excess of receipts by the United States over outlays in the vital area of lending and investing. This excess is what provides the money to pay for the excess of imports over exports.

_____89. It is in the very nature of foreign investment that it be accompanied by a so-called unfavorable balance of trade in the country receiving the investment, because the way that one country physically invests in another is by sending in the equipment and materials to build up the recipient country's means of production, and by sending in consumers' goods to supply the workers involved. For example, Western investment in building up Saudi Arabia's oil industry entailed the arrival of many shiploads of Western goods in Saudi Arabia, bringing in the necessary equipment, construction materials, and consumers' goods for Western workmen.

_____90. The purchase of imports does not represent any significant carrying out of money from the United States or any reduction in total, overall spending for goods and services in the United States. On the contrary, the imports represent new and additional wealth brought into the United States, where they are added to the supply of domestically produced goods and made available for purchase by the same total expenditure of money that would otherwise take place.

_____91. The rise in the foreign exchange value of a country's money that foreign investment in the country causes not only does not cause unemployment in that country, but actually tends to be accompanied by *less* unemployment in that country, because the foreign investment serves to increase the demand for labor in that country.

_____92. The prohibition or forced reduction of auto and steel imports would reduce unemployment in those industries but, in the absence of wage rate reductions, increase unemployment in the rest of the economic system, since reduced imports of autos and steel would be accompanied by reduced exports of other goods and/or increased imports of other goods.

_____93. The results of the reduction or elimination of foreign investment and the excess of imports over exports that is the accompaniment of net foreign investment would include a rise in prices resulting from the loss of the supply of goods representing the excess of imports over exports, and a reduction in employment and/or wage rates resulting from the fall in the demand for labor that rested on foreign investment.

_____94. What is called a favorable balance of trade can in fact be fully as much unfavorable as an allegedly unfavorable one is favorable, as, for example, if it results from such a thing as the granting of foreign aid the proceeds of which are used to finance exports. Such a case is comparable to the doorman of a restaurant giving money to passersby on the condition that they will spend it in eating at that restaurant.

_____95. Under an international gold standard,

a. the world's money supply, other things being equal, would tend to be distributed among the various individual countries in proportion to the relative size of their respective economies, which implies that there would be relatively increasing money supplies in countries with above average rates of economic progress and relatively decreasing money supplies in countries with below average rates of economic progress
b. consistent with the operation of the principle just named, a country with extensive gold mines would most likely experience an "unfavorable" balance of payments, while a country without them would most likely experience a "favorable" balance of payments; otherwise, the money supplies of the different countries would not correspond to the relative size of their respective economies
c. given the relative size of the various countries' economies in the world, and given the world's quantity of money, the balance of trade and payments of all countries always tends toward balance
d. labor union activities, by virtue of retarding or preventing the rise in the productivity of labor and in causing unemployment, operate to reduce the size of a country's economy in comparison to what it would otherwise have been and thus to reduce its share of the world's money supply in comparison with what it would otherwise have been
e. to the extent that labor union activities reduce the quantity of money that can accompany full employment in a country's economy, they reduce the height of money wage rates that can accompany full employment in that country
f. all of the above

_____96. Under a system of various fiat moneys in the economies of the different countries,

a. the world's money supply is distributed among the different countries in essentially the same way as it is under an international gold standard
b. the distribution of the world's money supply can be found in the combination of the number of units of the various currencies and their respective currency exchange rates, so that, for example, if the United States has a money supply of $2 trillion while Japan has a money supply of ¥140 trillion, and the exchange rate is 140 yen to the dollar, the US money supply is twice that of Japan
c. if the economy of one country grows relatively to that of another, either the number of units in its money supply will tend to grow in the same proportion relative to the number of units in the

money supply of the other country, or its exchange rate will rise in proportion to the relative increase in the size of its economy, or some combination of these two will occur
d. all of the above

_____97. Under an international gold standard, the creation of fiduciary media in any one country operates to cause a drain of gold from that country, because
a. its creation of fiduciary media is tantamount to an enlargement of the world's money supply
b. the country cannot, other things being equal, retain a quantity of money greater than corresponds to the relative size of its economy in the world economy, so that if, for example, the increase in its supply of fiduciary media is equivalent to a 1 percent increase in the world's supply of money, while its economy is ten percent of the world's economy, the country can retain only one tenth of the amount by which it has increased the world's money supply
c. other countries will most likely wish to receive their portion of the additional world supply of money in gold, rather than the paper of the expanding country
d. all of the above

_____98. Under a system of various fiat moneys in the economies of the different countries, the creation of additional money, whether fiduciary media or standard money, in any one country will cause it either to lose foreign currency reserves or, lacking sufficient such reserves, suffer a devaluation of its currency relative to foreign currencies.

_____99. What explains an "unfavorable" balance of payments in the sense of an actual outflow of money from a country is that the citizens of the country have an insufficient demand for that money to keep it in the country. In essence, they wish to hold a quantity of money corresponding to the relative size of their country's economy in the world, plus or minus an amount that corresponds to the special circumstances of their country and their psychology. They do not wish to hold the larger quantity of money that presently exists in their country, most probably as the result of credit expansion or other domestic inflation of the money supply. And as a result, they seek to spend it abroad and not replace it.

_____100. In the circumstances described in the preceding question, it is futile to try to keep the excess quantity of money in the country by such measures as blocking this or that category of imports or encouraging this or that category of exports, for so long as the money is present in the country and the citizens do not wish to hold it, it will serve to raise domestic prices relative to foreign prices. This in turn encourages imports and discourages exports, with the result that as soon as one category of import is prohibited, people turn to one or more others, and as soon as an additional line of exports is forced into existence, some other line or lines of exports becomes uncompetitive or imports are stepped up.

_____101. In contrast to the circumstances applying to the last two questions, when the citizens of a country do have a demand for its existing quantity of money, no amount of outlays to abroad will for very long deprive them of any part of that quantity of money. As illustration, imagine, for example, that a new foreign aid bill is passed and that, as part of it, an army of tax collectors is dispatched into the streets to seize money from every passerby and from every shopkeeper and businessman. The money, we can imagine, is then loaded into armored cars, rushed to nearby airports, and then flown to various foreign capitals
a. This foreign aid will *not* for very long be at the expense of the cash holdings of the American people. The American people cannot afford such a reduction in their cash holdings. They will be compelled to replace those cash holdings
b. To replace their cash holdings, they will have to sell more and buy less, and borrow more and lend less. The effect of this will very soon be a combination of lower domestic prices and higher domestic interest rates
c. The effect of this in turn is decreased American imports and increased American exports, and decreased American lending to abroad and increased American borrowing from abroad. This goes on until American cash holdings are restored to approximately their former level
d. all of the above

_____102. In the light of the answer to the preceding question, the observation of Adam Smith that "the attention of government never was so unnecessarily employed, as when directed to watch over the preservation or increase of the quantity of money in any country" seems simplistic.

_____103. What needs to be understood in connection with the balance of trade and payments viewed as source of changes in the quantity of money in a country is that the change in the stock of money in people's pockets, like the change in the stock of food in their refrigerators, is fully within their control and that their decisions about changes in the stock determine the relationship between their receipts and outlays, not that the relationship between their receipts and outlays determines the change in the stock.

_____104. A man owns a refrigerator into which from time to time he puts food and from which from time to time he takes food.
a. The change in the stock of food in the refrigerator is caused by the difference between the extent to which food is put into and taken out of the refrigerator. If no food is put into the refrigerator while the man continually withdraws food from it, he will be in danger of running out of food. Steps will have to be taken to reduce his withdrawals of

food from the refrigerator and increase his deposits of food into the refrigerator
b. The man's decision about whether to increase or decrease the stock of food in the refrigerator is the cause of the difference between the food that he puts into the refrigerator compared with the food that he takes out of the refrigerator. For example, if he plans to throw a party, he will be sure to stock the refrigerator and not to take from it items that he wants to save for his guests. Similarly, if he plans to go on vacation, he will tend to use up what he has in the refrigerator and not replace it. Changes in the stock of food in the refrigerator are entirely within the man's power and not a cause for concern.

_____105. In a free market, all other things being equal, the balance of payments of a country tends toward zero
a. because the effect of a positive balance of payments is to increase the quantity of money in a country that experiences it, while the effect of a negative balance of payments is to decrease the quantity of money in a country that experiences it
b. the effect of an increase in the quantity of money in a country is raise the prices of goods produced in that country, while the effect of a decrease in the quantity of money in a country is reduce the prices of goods produced in that country
c. the effect of higher prices of goods produced in a country is to discourage exports from it and encourage imports into it, which, in turn, serves to reduce its balance of payments, while the effect of lower prices of goods produced in a country is to encourage exports from it and discourage imports into it, which, in turn, serves to increase its balance of payments; thus positive balances diminish and negative balances increase
d. all of the above taken together

_____106. In a free market, the balance of payments of a country tends toward zero
a. in the absence of further changes in the world's quantity of money
b. in the absence of further changes in the relative size of the economies of the different countries
c. in the absence of further changes in the specific needs for cash holdings in the various countries, such as the degree of security of property and the development of financial institutions and financial markets in the various countries
d. all of the above taken together

_____107. It follows from the principle that the balance of payments of a country tends toward zero
a. that a unilateral tariff reduction by a country and any resulting surge in its imports would soon be followed by a diminution of the increase in its imports and an increase in its exports, until its balance of payments was in balance—provided that wage rates and thus costs and prices in that country were free to fall
b. that in a country in which wage rates and thus costs and prices were free to fall, the adoption of international free trade, even unilaterally, would not entail any lasting unemployment but a shift in employment from the relatively less efficient production of goods for domestic consumption to the relatively more efficient production of goods for export, with the attendant consequence of a higher standard of living at home and abroad
c. that an essential requirement of being able to adapt to international free trade and its possible consequence of a temporary outflow of money is the absence of legislation aimed at artificially raising wage rates or forcibly maintaining any given level of wage rates
d. all of the above

_____108. In the light of the proposition that the balance of payments tends toward zero, it follows that if a country pursued a policy of international free trade, while all other countries absolutely and successfully prohibited the importation of its goods, that ultimately that country would cease importing, because the decrease in its money supply and equivalent increase in the money supply of the rest of the world would so reduce the level of wages, costs, and prices in it compared to the level of wages, costs, and prices, in the rest of the world, as to remove the incentive of its citizens to buy anything abroad.

Invariable Money

_____109. Depending on circumstances, changes in prices reflect
a. changes taking place on the side of goods, such as changes in the supply of various goods and changes in the need or desire for various goods
b. changes taking place on the side of money, notably an increase or decrease in the supply of money or an increase or decrease in the demand for money for holding, such as occurs whenever there is inflation or deflation
c. both (a) and (b)

_____110. The variability of the value of money coming from the side of money applies even to a pure gold or silver standard—i.e., to a 100-percent-reserve gold or silver standard—if for no other reason, then because the supply of gold and silver tends steadily to increase as the result of their continued mining and substantially smaller annual loss or disappearance. This serves either to make prices higher from year to year or at least to make them fall by less than they would have in the absence of such change on the side of money.

_____111. In order for a money to serve as an *invariable standard of value*, it would have to be such

that changes in prices would reflect exclusively changes operating on the side of goods, not money.

_____112. The kind of money that would render all changes in the prices of goods having to come from changes on the side of goods and not from changes on the side of money,

a. would be one in which the total annual expenditure to buy newly produced goods—and equivalently, total business sales revenues in selling same—was a fixed, constant amount, such as one trillion dollars or twenty trillion dollars, i.e., any definite, fixed dollar amount

b. A fixed total expenditure for newly produced goods and equivalently fixed total business sales revenues in selling same, would be the result of a fixed quantity of money times a fixed velocity of circulation of money in relation to newly produced goods

c. Under such an invariable money, all changes in the general consumer price level would reflect increases or decreases in the supply of consumers' goods—they would, indeed, be inversely proportionate to such supply changes

d. Under such an invariable money, all changes in the relative prices of individual consumers' goods, such as the price of apples relative to the price of oranges, or the price of both relative to the price of automobiles or steel, would reflect a combination of changes in their relative supplies and in the relative need or desire for them at the margin. (In the case of goods like automobiles and steel, whose prices are typically determined in the first instance on the basis of their cost of production, the relevant supplies and demands are of/for means of production.)

e. Under such an invariable money, a definite elasticity of aggregate demand is implied equal to unity, because a constant expenditure implies that quantity demanded changes in inverse proportion to price—e.g., doubles when the price level halves, halves when the price level doubles

f. all of the above

_____113. The concept of invariable money implies

a. that every measure of velocity must remain unchanged

b. only velocity in relation to the demand for newly produced goods must remain unchanged

_____114. Ricardo believed that in order for gold to serve as an invariable standard of value an ounce of gold would always have to be the product of the same quantity of labor of the same degree of skill and ability.

_____115. Hazlitt expresses no opinion, explicit or implicit, concerning an invariable money.

_____116. The concept of an invariable money as a tool of analysis represents the adoption of a procedure analogous to that of mechanics when it conceives of such a thing as the velocity of a moving body as the joint outcome of the operation of separate, distinct forces.

_____117. The assumption of an invariable money is made, implicitly, by everyone who thinks about economic phenomena on the assumption of all other things being equal, for among those other things is almost always the total volume of spending in the economic system.

_____118. The concept of invariable money and recognition of the fact that money is not in fact invariable sheds light on the respective roles of a system of fiat paper money and the businessman's profit motive in the causation of the rising prices we have seen almost all around us.

_____119. Among the uses that will be made of the concept of invariable money in the chapters ahead are

a. the isolation of the distinct determinants of the average rate of profit in the economic system

b. recognition of important cases in which money income and real income can move in opposite directions

c. analysis of the nature of inflation and deflation

d. analysis of the effect of increases in production and accompanying falling prices on the rate of profit and on the difficulty of repaying debt

e. analysis of the role of saving in capital accumulation and of the effect of saving on the average rate of profit

f. analysis of the causes of capital accumulation

g. all of the above

Answers to Questions 1-119 on Chapter 12.

Question#	Correct Answer	Question#	Correct Answer	Question#	Correct Answer
1	a	41	F	81	T
2	T	42	d	82	T
3	T	43	c	83	T
4	T	44	c	84	T
5	c	45	c	85	c
6	4.1	46	T	86	b
7	c	47	T	87	T
8	d	48	T	88	T
9	T	49	T	89	T
10	T	50	d	90	T
11	2%	51	T	91	T
12	35 years	52	c	92	T
13	9 years	53	e	93	T
14	T	54	T	94	T
15	e	55	T	95	f
16	T	56	e	96	d
17	F	57	T	97	d
18	d	58	F	98	T
19	400%	59	d	99	T
20	c	60	c	100	T
21	F	61	F	101	d
22	T	62	T	102	F
23	T	63	d	103	T
24	T	64	T	104	b
25	d	65	T	105	d
26	d	66	e	106	d
27	d	67	c	107	d
28	T	68	T	108	T
29	e	69	F	109	c
30	d	70	b	110	T
31	a	71	F	111	T
32	T	72	F	112	f
33	T	73	F	113	b
34	T	74	T	114	T
35	T	75	c	115	F
36	c	76	a	116	T
37	T	77	T	117	T
38	T	78	b	118	T
39	F	79	T	119	g
40	c	80	f		