Chapter 3
What Is Money?

3.1 Meaning of Money

1) Economists find no completely satisfactory way to measure money because
   A) money supply statistics are a state secret.
   B) the Federal Reserve does not employ or report different measures of the money supply.
   C) the "moneyness" or liquidity of an asset is a matter of degree.
   D) economists find disagreement interesting and refuse to agree for ideological reasons.

   Answer: C
   Ques Status: Previous Edition

2) To an economist, _______ is anything that is generally accepted in payment for goods and services or in the repayment of debt.
   A) wealth
   B) income
   C) money
   D) credit

   Answer: C
   Ques Status: New

3) Currency includes
   A) paper money and coins.
   B) paper money, coins, and checks.
   C) paper money and checks.
   D) paper money, coins, checks, and savings deposits.

   Answer: A
   Ques Status: Previous Edition

4) The difference between money and income is that
   A) money is a flow and income is a stock.
   B) money is a stock and income is a flow.
   C) there is no difference—money and income are both stocks.
   D) there is no difference—money and income are both flows.

   Answer: B
   Ques Status: Previous Edition
5) It is true that
   A) income and wealth are both stocks.
   B) money and income are both stocks.
   C) income is a flow and wealth is a stock.
   D) money and wealth are both flows.

   Answer: C
   Ques Status: Revised

6) An individual's annual salary is her
   A) money.
   B) income.
   C) wealth.
   D) liabilities.

   Answer: B
   Ques Status: Revised

7) A person's house is part of her
   A) money.
   B) income.
   C) liabilities.
   D) wealth.

   Answer: D
   Ques Status: Revised

8) Money is
   A) anything that is generally accepted in payment for goods and services or in the repayment of debt.
   B) a flow of earnings per unit of time.
   C) the total collection of pieces of property that are a store of value.
   D) always based on a precious metal like gold or silver.

   Answer: A
   Ques Status: Revised
9) Which of the following are true statements?
   A) Wealth is a stock variable.
   B) Money is a flow variable.
   C) Income is a stock variable.
   D) Wealth is a flow variable.

   Answer: A
   Ques Status: Revised

10) ________ is used to make purchases while ________ is the total collection of pieces of property that serve to store value.

    A) Money; income
    B) Wealth; income
    C) Income; money
    D) Money; wealth

   Answer: D
   Ques Status: New

11) ________ is a flow of earnings per unit of time.

    A) Income
    B) Money
    C) Wealth
    D) Currency

   Answer: A
   Ques Status: New

12) Which of the following statements uses the economists’ definition of money?

    A) I plan to earn a lot of money over the summer.
    B) Betsy is rich—she has a lot of money.
    C) I hope that I have enough money to buy my lunch today.
    D) The job with New Company gave me the opportunity to earn more money.

   Answer: C
   Ques Status: New
3.2 Functions of Money

1) Of money’s three functions, the one that distinguishes money from other assets is its function as a
   A) store of value.
   B) unit of account.
   C) standard of deferred payment.
   D) medium of exchange.

   Answer: D
   Ques Status: Previous Edition

2) If peanuts serve as a medium of exchange, a unit of account, and a store of value, then peanuts are
   A) bank deposits.
   B) reserves.
   C) money.
   D) loanable funds.

   Answer: C
   Ques Status: Revised

3) The conversion of a barter economy to one that uses money
   A) increases efficiency by reducing the need to exchange goods and services.
   B) increases efficiency by reducing the need to specialize.
   C) increases efficiency by reducing transactions costs.
   D) does not increase economic efficiency.

   Answer: C
   Ques Status: Previous Edition

4) When compared to exchange systems that rely on money, disadvantages of the barter system include:
   A) the requirement of a double coincidence of wants.
   B) lowering the cost of exchanging goods over time.
   C) lowering the cost of exchange to those who would specialize.
   D) encouraging specialization and the division of labor.

   Answer: A
   Ques Status: Revised
5) When economists say that money promotes ________, they mean that money encourages specialization and the division of labor.
   A) bargaining
   B) contracting
   C) efficiency
   D) greed
   Answer: C
   Ques Status: New

6) Which of the following statements best explains how the use of money in an economy increases economic efficiency?
   A) Money increases economic efficiency because it is costless to produce.
   B) Money increases economic efficiency because it discourages specialization.
   C) Money increases economic efficiency because it decreases transactions costs.
   D) Money cannot have an effect on economic efficiency.
   Answer: C
   Ques Status: Revised

7) For a commodity to function effectively as money it must be
   A) easily standardized, making it easy to ascertain its value.
   B) difficult to make change.
   C) deteriorate quickly so that its supply does not become too large.
   D) hard to carry around.
   Answer: A
   Ques Status: Revised

8) All but the most primitive societies use money as a medium of exchange, implying that
   A) the use of money is economically efficient.
   B) barter exchange is economically efficient.
   C) barter exchange cannot work outside the family.
   D) inflation is not a concern.
   Answer: A
   Ques Status: Revised
9) Whatever a society uses as money, the distinguishing characteristic is that it must
   A) be completely inflation proof.
   B) be generally acceptable as payment for goods and services or in the repayment of debt.
   C) contain gold.
   D) be produced by the government.

   Answer: B

10) ________ are the time and resources spent trying to exchange goods and services.
   A) Bargaining costs.
   B) Transaction costs.
   C) Contracting costs.
   D) Barter costs.

   Answer: B

11) Compared to an economy that uses a medium of exchange, in a barter economy
   A) transaction costs are higher.
   B) transaction costs are lower.
   C) liquidity costs are higher.
   D) liquidity costs are lower.

   Answer: A

12) Money ________ transaction costs, allowing people to specialize in what they do best.
   A) reduces
   B) increases
   C) enhances
   D) eliminates

   Answer: A
13) Kevin purchasing concert tickets with his debit card is an example of the ______ function of money.

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

Answer: A

Ques Status: New

14) When money prices are used to facilitate comparisons of value, money is said to function as a

A) unit of account.
B) medium of exchange.
C) store of value.
D) payments-system ruler.

Answer: A

Ques Status: Previous Edition

15) Because it is a unit of account, money

A) increases transaction costs.
B) reduces the number of prices that need to be calculated.
C) does not earn interest.
D) discourages specialization.

Answer: B

Ques Status: Revised

16) A problem with barter exchange when there are many goods is that in a barter system

A) transactions costs are minimized.
B) there exists a multiple number of prices for each good.
C) there is only one store of value.
D) exchange of services is impossible.

Answer: B

Ques Status: Revised
17) In a barter economy the number of prices in an economy with N goods is
   A) \( \frac{N(N - 1)}{2} \).
   B) \( N(N/2) \).
   C) 2N.
   D) \( N(N/2) - 1 \).

   Answer: A

18) Dennis notices that jackets are on sale for $99. In this case money is functioning as a ________.
   A) medium of exchange
   B) unit of account
   C) store of value
   D) payments-system ruler

   Answer: B

19) If there are five goods in a barter economy, one needs to know ten prices in order to exchange one good for another. If, however, there are ten goods in a barter economy, then one needs to know ________ prices in order to exchange one good for another.
   A) 20
   B) 25
   C) 30
   D) 45

   Answer: D

20) If there are four goods in a barter economy, then one needs to know ________ prices in order to exchange one good for another.
   A) 8
   B) 6
   C) 5
   D) 4

   Answer: B
21) Because it is a store of value, money
   A) does not earn interest.
   B) cannot be a durable asset.
   C) must be currency.
   D) is a way of saving for future purchases.

   Answer: D
   Ques Status: Revised

22) Patrick places his pocket change into his savings bank on his desk each evening. By his actions, Patrick indicates that he believes that money has a ________ function.

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

   Answer: C
   Ques Status: New

23) ________ is the relative ease and speed with which an asset can be converted into a medium of exchange.

   A) Efficiency
   B) Liquidity
   C) Deflation
   D) Specialization

   Answer: B
   Ques Status: New

24) Increasing transactions costs of selling an asset make the asset

   A) more valuable.
   B) more liquid.
   C) less liquid.
   D) more moneylike.

   Answer: C
   Ques Status: Revised
25) Of the following assets, the least liquid is
   A) stocks.
   B) traveler's checks.
   C) checking deposits.
   D) a house.
   Answer: D

26) Ranking assets from most liquid to least liquid, the correct order is
   A) savings bonds; house; currency.
   B) currency; savings bonds; house.
   C) currency; house; savings bonds.
   D) house; savings bonds; currency.
   Answer: B

27) People hold money even during inflationary episodes when other assets prove to be better stores of value. This can be explained by the fact that money is
   A) extremely liquid.
   B) a unique good for which there are no substitutes.
   C) the only thing accepted in economic exchange.
   D) backed by gold.
   Answer: A

28) If the price level doubles, the value of money
   A) doubles.
   B) more than doubles, due to scale economies.
   C) rises but does not double, due to diminishing returns.
   D) falls by 50 percent.
   Answer: D
29) A fall in the level of prices
   A) does not affect the value of money.
   B) has an uncertain effect on the value of money.
   C) increases the value of money.
   D) reduces the value of money.

   Answer: C
   Ques Status: Revised

30) During hyperinflations,
   A) the value of money rises rapidly.
   B) money no longer functions as a good store of value and people may resort to barter transactions on a much larger scale.
   C) middle-class savers benefit as prices rise.
   D) money’s value remains fixed to the price level; that is, if prices double so does the value of money.

   Answer: B
   Ques Status: Revised

31) Because inflation in Nicaragua in 1990 topped 13,000 percent, one can conclude that the Nicaraguan economy suffered from
   A) deflation.
   B) disinflation.
   C) hyperinflation.
   D) superdeflation.

   Answer: C
   Ques Status: Previous Edition

32) If merchants in the country Zed choose to close their doors, preferring to be stuck with rotting merchandise rather than worthless currency, then one can conclude that Zed is experiencing a
   A) superdeflation.
   B) hyperdeflation.
   C) disinflation.
   D) hyperinflation.

   Answer: D
   Ques Status: Previous Edition
33) Explain how cigarettes could be called "money" in prisoner-of-war camps of World War II.

Answer: The cigarettes performed the three functions of money. They served as the medium of exchange because individuals did exchange items for cigarettes. They served as a unit of account because prices were quoted in terms of the number of cigarettes required for the exchange. They served as a store of value because an individual would be willing to save their cigarettes even if they did not smoke because they believed that they could exchange the cigarettes for something that they did want at some time in the future.

Ques Status: New

3.3 Evolution of The Payments System

1) Compared to checks, paper currency and coins have the major drawbacks that they
   A) are easily stolen.
   B) are hard to counterfeit.
   C) are not the most liquid assets.
   D) must be backed by gold.

Answer: A

Ques Status: Revised

2) As the payments system evolves from barter to a monetary system,
   A) commodity money is likely to precede the use of paper currency.
   B) transaction costs increase.
   C) the number of prices that need to be calculated increase rather dramatically.
   D) specialization decreases.

Answer: A

Ques Status: Revised

3) A disadvantage of _______ is that it is very heavy and hard to transport from one place to another.
   A) commodity money
   B) fiat money
   C) electronic money
   D) paper money

Answer: A

Ques Status: New
4) Paper currency that has been declared legal tender but is not convertible into coins or precious metals is called _______ money.
   
   A) commodity  
   B) fiat  
   C) electronic  
   D) funny  

   Answer: B  
   Ques Status: New

5) When paper currency is decreed by governments as legal tender, legally it must be _______.
   
   A) paper currency backed by gold  
   B) a precious metal such as gold or silver  
   C) accepted as payment for debts  
   D) convertible into an electronic payment  

   Answer: C  
   Ques Status: New

6) The evolution of the payments system from barter to precious metals, then to fiat money, then to checks can best be understood as a consequence of
   
   A) government regulations designed to improve the efficiency of the payments system.  
   B) government regulations designed to promote the safety of the payments system.  
   C) innovations that reduced the costs of exchanging goods and services.  
   D) competition among firms to make it easier for customers to purchase their products.  

   Answer: C  
   Ques Status: Revised

7) The evolution of the payments system from barter to precious metals, then to fiat money, then to checks can best be understood as a consequence of the fact that
   
   A) paper is more costly to produce than precious metals.  
   B) precious metals were not generally acceptable.  
   C) precious metals were difficult to carry and transport.  
   D) paper money is less accepted than checks.  

   Answer: C  
   Ques Status: Revised
8) Which of the following sequences accurately describes the evolution of the payments system?
   A) Barter, coins made of precious metals, paper currency, checks, electronic funds transfers
   B) Barter, coins made of precious metals, checks, paper currency, electronic funds transfers
   C) Barter, checks, paper currency, coins made of precious metals, electronic funds transfers
   D) Barter, checks, paper currency, electronic funds transfers

   Answer: A
   Ques Status: Previous Edition

9) In explaining the evolution of money
   A) government regulation is the most important factor.
   B) commodity money, because it is valued more highly, tends to drive out paper money.
   C) new forms of money evolve to lower transaction costs.
   D) paper money is always backed by gold and therefore more desirable than checks.

   Answer: C
   Ques Status: Revised

10) During the past two decades an important characteristic of the modern payments system has been the rapidly increasing use of
    A) checks and decreasing use of currency.
    B) electronic fund transfers.
    C) commodity monies.
    D) fiat money.

    Answer: B
    Ques Status: Revised

11) Compared to an electronic payments system, a payments system based on checks has the major drawback that
    A) checks are less costly to process.
    B) checks take longer to process, meaning that it may take several days before the depositor can get her cash.
    C) fraud may be more difficult to commit when paper receipts are eliminated.
    D) legal liability is more clearly defined.

    Answer: B
    Ques Status: Revised
12) A smart card is the equivalent of
   A) cash.
   B) savings bonds.
   C) savings deposits.
   D) certificates of deposit.

   Answer: A
   Ques Status: Revised

13) Which of the following is not a form of e-money?
   A) a debit card
   B) a credit card
   C) a stored-value card
   D) a smart card

   Answer: B
   Ques Status: New

14) Which of the following reasons would not explain why electronic payments have been slow to displace the paper payments system?
   A) expensive equipment is necessary to set up the system
   B) security concerns
   C) privacy concerns
   D) transportation costs

   Answer: D
   Ques Status: New

15) What factors have slowed down the movement to a system where all payments are made electronically?

   Answer: The equipment necessary to set up the system is expensive, security of the information, and privacy concerns are issues that need to be addressed before an electronic payments system will be widely accepted.

   Ques Status: New
3.4 Measuring Money

1) Recent financial innovation makes the Federal Reserve's job of conducting monetary policy
   A) easier, since the Fed now knows what to consider money.
   B) more difficult, since the Fed now knows what to consider money.
   C) easier, since the Fed no longer knows what to consider money.
   D) more difficult, since the Fed no longer knows what to consider money.

   Answer: D
   Ques Status: Previous Edition

2) Defining money becomes _______ difficult as the pace of financial innovation _______.
   A) less; quickens
   B) more; quickens
   C) more; slows
   D) more; stops

   Answer: B
   Ques Status: Revised

3) _______ is the narrowest monetary aggregate that the Fed reports.
   A) M0
   B) M1
   C) M2
   D) M3

   Answer: B
   Ques Status: New

4) Which of the following is not included in the measure of M1?
   A) NOW accounts.
   B) Demand deposits.
   C) Currency.
   D) Savings deposits.

   Answer: D
   Ques Status: Previous Edition


5) The components of the U.S. M1 money supply are demand and checkable deposits plus
   A) currency.
   B) currency plus savings deposits.
   C) currency plus travelers checks.
   D) currency plus travelers checks plus money market deposits.

   Answer: C
   Ques Status: Previous Edition

6) The M1 measure of money includes
   A) small denomination time deposits.
   B) traveler's checks.
   C) money market deposit accounts.
   D) money market mutual fund shares.

   Answer: B
   Ques Status: Revised

7) The currency component includes paper money and coins held in ________.
   A) bank vaults
   B) ATMs
   C) the hands of the nonbank public
   D) the central bank

   Answer: C
   Ques Status: New

8) Which of the following is not included in the monetary aggregate M2?
   A) Currency
   B) Savings bonds
   C) Traveler's checks
   D) Checking deposits

   Answer: B
   Ques Status: Revised
9) Which of the following is included in M2 but not in M1?
   A) NOW accounts
   B) Demand deposits
   C) Currency
   D) Money market mutual fund shares (retail)

   Answer: D
   Ques Status: Revised

10) Which of the following is not included in the M1 measure of money but is included in the M2 measure of money?
    A) Currency
    B) Traveler’s checks
    C) Demand deposits
    D) Small-denomination time deposits

    Answer: D
    Ques Status: Previous Edition

11) Which of the following is included in both M1 and M2?
    A) Currency
    B) Savings deposits
    C) Small-denomination time deposits
    D) Money market deposit accounts

    Answer: A
    Ques Status: Revised

12) Of the following, the largest is
    A) money market deposit accounts.
    B) demand deposits.
    C) M1.
    D) M2.

    Answer: D
    Ques Status: Revised
13) If an individual redeems a U.S. savings bond for currency
   A) M1 stays the same and M2 decreases.
   B) M1 increases and M2 increases.
   C) M1 increases and M2 stays the same.
   D) M1 stays the same and M2 stays the same.

   Answer: B
   Ques Status: Revised

14) If an individual moves money from a small-denomination time deposit to a demand deposit account,
   A) M1 increases and M2 stays the same.
   B) M1 stays the same and M2 increases.
   C) M1 stays the same and M2 stays the same.
   D) M1 increases and M2 decreases.

   Answer: A
   Ques Status: Previous Edition

15) If an individual moves money from a demand deposit account to a money market deposit account,
   A) M1 decreases and M2 stays the same.
   B) M1 stays the same and M2 increases.
   C) M1 stays the same and M2 stays the same.
   D) M1 increases and M2 decreases.

   Answer: A
   Ques Status: Previous Edition

16) If an individual moves money from a savings deposit account to a money market deposit account,
   A) M1 decreases and M2 stays the same.
   B) M1 stays the same and M2 increases.
   C) M1 stays the same and M2 stays the same.
   D) M1 increases and M2 decreases.

   Answer: C
   Ques Status: Previous Edition
17) If an individual moves money from currency to a demand deposit account,
   A) M1 decreases and M2 stays the same.
   B) M1 stays the same and M2 increases.
   C) M1 stays the same and M2 stays the same.
   D) M1 increases and M2 stays the same.
   Answer: C
   Ques Status: Previous Edition

18) If an individual moves money from a money market deposit account to currency,
   A) M1 increases and M2 stays the same.
   B) M1 stays the same and M2 increases.
   C) M1 stays the same and M2 stays the same.
   D) M1 increases and M2 decreases.
   Answer: A
   Ques Status: Previous Edition

19) Small-denomination time deposits refer to certificates of deposit with a denomination of less than ________.
   A) $1,000
   B) $10,000
   C) $100,000
   D) $1,000,000
   Answer: C
   Ques Status: New

20) The growth rates of monetary aggregates
   A) follow one another exactly.
   B) tend to move together in the short run but not in the long run.
   C) are unrelated in the long run.
   D) tend to move together in the long run but can diverge in the short run.
   Answer: D
   Ques Status: Revised
21) The decade during which the growth rates of monetary aggregates diverged the most is
   A) the 1960s.
   B) the 1970s.
   C) the 1980s.
   D) the 1990s.

   Answer: D
   Ques Status: Revised

22) Why are most of the U.S. dollars held outside of the United States?

   Answer: Concern about high inflation eroding the value of their own currency causes many people in foreign countries to hold U.S. dollars as a hedge against inflation risk.
   Ques Status: New

3.5 How Reliable Are the Money Data?

1) Generally, the data initially reported by the Fed are
   A) not a reliable guide to the short-run behavior of the money supply.
   B) not a reliable guide to the long-run behavior of the money supply.
   C) a reliable guide to the short-run behavior of the money supply.
   D) usually underestimate the revised statistics.

   Answer: A
   Ques Status: Revised

2) An examination of revised money supply statistics, when compared to the initial statistics, suggests that the initial statistics
   A) are pretty good.
   B) do not provide a good guide to short-run movements in the money supply.
   C) provide a poor guide of monetary policy because they are usually underestimates of the revised statistics.
   D) provide a good guide of monetary policy, though they are usually underestimates of the revised statistics.

   Answer: B
   Ques Status: Previous Edition
3) The Fed revises its estimates of the monetary aggregates, sometimes by large amounts, because

A) large depository institutions need only report their deposits infrequently.  
B) weekly monetary data need to be adjusted for the "weekend effect."  
C) monthly monetary data need to be adjusted for the "payday effect."  
D) seasonal adjustments become more precise only as more data becomes available. 

Answer: D  
Ques Status: Revised

4) The Fed estimates initial monetary aggregate reports because ________ depository institutions report the amount of their deposits infrequently. 

A) all  
B) small  
C) large  
D) state 

Answer: B  
Ques Status: New

5) The increase in holiday spending is not the same every year causing the Fed’s adjustment for ________ to be revised as more data becomes available. 

A) seasonal variation  
B) reporting discrepancy  
C) market churning  
D) transactions discrepancy 

Answer: A  
Ques Status: New

6) Which of the following statements accurately describes the two measures of the money supply? 

A) The two measures do not move together, so they cannot be used interchangeably by policymakers.  
B) The two measures’ movements closely parallel each other, even on a month–to-month basis.  
C) Short-run movements in the money supply are extremely reliable.  
D) M2 is the narrowest measure the Fed reports. 

Answer: A  
Ques Status: Revised