Econ 371: Problem Set 5 (Chapter 18)

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November 21, 2005
Due date: November 30, 2005

**PART 1:** Answer whether the following statements are true or false. When you think it is true, write "T" in front of the question. Write "F" otherwise. (1 point each)

1. Despite the N-1 problem, the rest of the world fixes its exchange rate with the U.S. dollar in order to import low inflation from the U.S.

2. Under the gold standard, central banks have no control over its monetary policy because of the price-specie-flow mechanism.

3. Under the gold standard, a new discovery of silver raises gold price and creates inflation.

4. The price-specie-flow mechanism works even when gold price fluctuates as a result of a new discovery of gold.

5. Countries reach their external balance when exports and imports are equal.

6. The Bretton Woods system does not allow member countries to adjust their exchange rate unless the country runs a large fiscal deficit.

**PART 2** (2 points each)

1. Explain the impacts of the return of the U.S. to the gold standard after the World War I on the central bank’s balance sheet and price level. Is it true that it is a cause of the Great Depression?

2. Explain the suspension of convertability between dollar and gold by President Nixon in 1971 in the context of a currency crisis.