Econ 371: Problem Set 5 (Chapter 18)

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Due date: April 25, 2005

Instruction: 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. The gold and gold exchange standard does not suffer with the N-1 problem.

2. If the U.S. did not return to the gold standard after the World War I, the deflation in that period would have been less severe.

3. With the gold standard, a discovery of new gold supply causes gold price to fall and then creates deflation.

4. The price-specie-flow mechanism works when countries do not regulate cross-border flows of gold.

5. For a central bank in a small open economy such as Brazil, the external balance is more important than the internal balance.

6. The optimal level of current account balance is zero.

7. The optimal internal balance is the full employment level of output and employment.

8. With fixed exchange rate, we can reach the internal and external balance in the short run by implementing fiscal policy.

9. When a country fixes its exchange rate to the U.S. dollar, its central bank cannot alter its liabilities and assets in the balance sheet.

10. The Bretton Woods system would not break down if other industrialized countries were willing to import expansionary monetary policy from the U.S.

Practice Questions: The following questions are optional. We will not assign score for you but will provide the answer key.
1. What is the price-specie-flow mechanism? Explain how it works.

2. Explain how returning to the gold standard became a cause of the Great Depression.

3. Explain the economic effects of the shutdown of gold-dollar exchanges by President Nixon in 1971.

4. Why did the the Bretton Woods System (or the IMF) allow countries that experienced persistent current account deficit to devalue their currency?