

Money and banking

CHAPTER

7

Name: _____

Class: _____ ()

A Tackling Typical Questions



Typical Question 1 Identifying the functions of money

Some chain stores, e.g., cake shops, sell cash coupons to their customers at discounts. Coupon holders can use the coupons as cash to make purchases at these stores.

- a. Name the function of money the coupons perform.
- b. Explain why the coupons do NOT perform the other functions of money.

1. Question analysis

Key word: a. 'name' and 'function of money'.

b. 'explain why', 'not perform' and 'other functions of money'.

- Cash coupons can be used to make purchases at the designated stores only.
- Name the function: Students are not required to explain the function mentioned.

2. Answering techniques

- List the four functions of money.
- Choose the one performed by the cash coupons.
- Explain why the coupons do not perform the other functions.

3. Suggested answer

- a. The function of money the cash coupons perform is a store of value.
- b.
 - The cash coupons do not perform the function of money as a medium of exchange because they are not commonly accepted for purchases at other shops.
 - The cash coupons are not a unit of account because the prices or values of the goods are not expressed in terms of the coupons.
 - The cash coupons are not a standard of deferred payments because future payments are not expressed in terms of the coupons.

B Correcting Common Errors

The following sentences contain mistakes. The corrections and underlying reasons are explained.

1. 'A good which can serve as a medium of exchange must be money.'



Correction

A good which is **generally accepted** as a medium of exchange is money.



Explanation

As long as goods are not directly exchanged for goods, there is a medium of exchange. A medium of exchange may not be generally accepted and so may not be money. For example, when a group of children agree to exchange their toys for playing cards and use the playing cards to buy toys from another child, playing cards are a medium of exchange. However, as playing cards are not generally accepted by the public as a medium of exchange, they are not money. Also, they do not perform the function of money as a medium of exchange.

Note: A 'medium of exchange' is different from 'the function of money as a medium of exchange'. A 'medium of exchange' refers to the medium used in specific transactions (where goods are not directly exchanged for goods), e.g., the playing cards in the above example. However, to perform 'the function of money as a medium of exchange', a good has to be generally accepted.

2. 'A standard of deferred payments is equivalent to a means of deferred payments.'



Correction

A standard of deferred payments is different from a means of deferred payments.



Explanation

When money serves as a standard of deferred payments, the future payments (or receipts) are expressed in terms of money. Although some devices such as credit cards can serve as a means of deferred payments, they are not a standard of deferred payments because the payments are not expressed in those terms.

3. 'Money is the same as cash.'



Correction

Money is different from cash.



Explanation

Cash is banknotes and coins which are generally accepted as a medium of exchange. However, apart from cash, money can include other components such as demand deposits. Therefore, cash is a part of money.

C Multiple Choice Questions

Choose the BEST answer for each question.

1. Which of the following about a barter economy is correct?

- (1) Without money, there is no way to store wealth.
- (2) Buying and selling cannot be separated.
- (3) The scope of exchange and specialisation is restricted.
- (4) Deferred payments are impossible.

- A. (1) and (2) only
- B. (1) and (4) only
- C. (2) and (3) only
- D. (2), (3) and (4) only

2. Which of the following can exist in a barter economy?

- (1) Common measure of value
- (2) Price competition
- (3) Lending and borrowing

- A. (3) only
- B. (1) and (2) only
- C. (2) and (3) only
- D. (1), (2) and (3)

3. In a barter economy, goods lack a common measure of value. This problem could be solved if

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- A. goods are homogeneous.
- B. goods can be divided into smaller units for transactions of small amounts.
- C. goods are easily portable.
- D. None of the above

4. There is no money

- A. in a one-man economy.
- B. if there is no legal tender.
- C. if there is no financial institution.
- D. All of the above

D Short Questions

Write your answers in the space provided.

1. In some monetary economies, barter trade is commonly found. Give TWO possible reasons to explain the existence of barter in a monetary economy. (4 marks)

2. In November 2014, the daily RMB20,000 cap on conversion limits for Hong Kong residents was removed. In other words, residents can buy and sell RMB without any upper limits.

- a. Explain which money function of renminbi would **NECESSARILY** be strengthened in Hong Kong after the removal of conversion limits. (2 marks)
- b. The highest denomination of a renminbi banknote is ¥100 whereas that of Hong Kong currency is \$1,000. Explain TWO advantages of using Hong Kong dollars over renminbi for transactions of large amounts in cash. (4 marks)

Answers

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Multiple Choice Questions

1. **C** Option (1) is incorrect. Without money, people can still store their wealth by saving their goods although this would involve a higher cost.
Option (2) is correct. In direct exchange, buying and selling must take place at the same time.
Option (3) is correct. Due to the high costs of exchange in barter, the exchange volume and the scope of specialisation are restricted.
Option (4) is incorrect. Future payments can still be made in terms of goods or services.
2. **C** Option (1) is incorrect. Without money, values of goods are expressed in terms of other goods. Hence, there is no common measure of value.
Option (2) is correct. Prices do exist in barter, although they are all relative prices.
Option (3) is correct. In barter, people can still lend and borrow goods and services.
3. **D** Option A is incorrect because even if goods are homogeneous, the price of a good still has to be expressed in terms of all other goods for which it is exchanged. The problem of a lack of a common measure of value still exists.
Options B and C relate to the cost of trading only. They do not relate to value measurement.
4. **A** Option A is correct because there is no exchange in a one-man economy.
Option B is incorrect because money is not necessarily legal tender (currency declared by the government). As long as people generally accept something as a medium of exchange, there is money.
Option C is incorrect. Even if there is no financial institution, there can still be money, e.g., commodity money.
5. **D** Option A is correct. When some shops refuse to accept \$1,000 notes, the notes are less generally accepted as a medium of exchange.
Option B is correct. When \$1,000 notes become less generally acceptable, their purchasing power are also weakened. Hence, the function of store of purchasing power by storing up \$1,000 notes is also weakened.
Option C is incorrect. Prices are not expressed in terms of \$1,000 banknotes.
6. **D** Option A is incorrect. As long as Bitcoins are generally accepted as a medium of exchange, they can be regarded as money even if they are not backed by any government.
Option B is incorrect. The value of Bitcoins is determined by their purchasing power. When the prices of goods in terms of Bitcoin change, its value (purchasing power) will change.
Option C is incorrect. Future payments can be expressed in terms of Bitcoins.
7. **C**
8. **D** Option A is incorrect. A credit card is not a medium of exchange, but a means to defer payment.
Option B is incorrect. The value of money depends on its purchasing power rather than its intrinsic value.
Option C is incorrect. During inflation, the purchasing power of money decreases. Hence, money performs less satisfactorily as a store of value.