

What is Money?
ECON 4673
Dr. Keen

Answers

1. *In prison, cigarettes are sometimes used among inmates as a means of payment. How is it possible for cigarettes to solve the “double coincidence of wants” problem, even if a prisoner does not smoke?*

Even if the prisoner is a non-smoker, he or she knows that others in the prison will accept cigarettes as a form of payment for goods and services. Thus, rather than having to barter and trade favors, cigarettes solve the double coincidence of wants problem because both parties involved in the transaction are willing and able to use them to “purchase” goods or services.

2. *Was money a better store of value in the United States in the 1950s than in the 1970s? Why or why not? In which period would you have been more willing to hold money?*

Money was losing its value at a slower rate (i.e., the inflation rate was lower) in the 1950s than in the 1970s, so it was a better store of value in the 1950s. Thus, you would have been willing to hold more of it during the 1950s.

3. *For each of the following assets, indicate which of the monetary aggregates (M1, M2 and MZM) includes them: a) Currency; b) Retail money market mutual funds; c) Institutional money market mutual funds; d) Small-denomination time deposits; and e) Demand deposits.*

- a) M1, M2, and MZM
- b) M2 and MZM
- c) MZM
- d) M2
- e) M1, M2, and MZM

4. *Assume that you are interested in earning some return on the idle balances you usually keep in your checking account and decide to buy some money market mutual funds shares by writing a check. Comment on the effect of your action (with everything else the same) on M1, M2, and MZM.*

Your actions will reduce your checking account balance and increase your holdings of money market mutual fund shares. This transaction will cause M1 to decrease as one of its components, other checking deposits, decrease. M2 and MZM, on the other hand, will both remain constant, as the decline in one of its components, other checking deposits, is offset by an increase in another one of its components, retail money market mutual funds.