**First Midterm Exam Study Guide**

***Conceptual session (45\*2.2=100):***

1. **Multilateral Trade Agreements With Their Pros, Cons and Examples**

5 Pros and 4 Cons to the World's Largest Trade Agreements

<https://www.thebalance.com/multilateral-trade-agreements-pros-cons-and-examples-3305949>

**BY** [**KIMBERLY AMADEO**](https://www.thebalance.com/kimberly-amadeo-3305455)  **REVIEWED BY** [**ERIC ESTEVEZ**](https://www.thebalance.com/eric-estevez-4800824) Updated October 28, 2020

**Multilateral trade agreements** are commerce treaties among three or more nations. The agreements **reduce**[**tariffs**](https://www.thebalance.com/tariff-pros-cons-and-examples-3305967)**and** make it easier for businesses to import and export. Since they are among many countries, they are **difficult to negotiate**.

That same broad scope makes them **more robust** than other types of trade agreements once all parties sign.

[**Bilateral agreements**](https://www.thebalance.com/what-are-bilateral-trade-agreements-pros-cons-and-list-3305911) are easier to negotiate but these are only between two countries. They **don't have as big an impact** on economic growth as does a multilateral agreement.

**5 Advantages of multilateral agreements**

·         **Multilateral agreements make all signatories treat each other equally. No country can give better trade deals to one country than it does to another.** That levels the playing field. It's especially critical for [emerging market countries](https://www.thebalance.com/what-are-emerging-markets-3305927). Many of them are smaller in size, making them less competitive. **The**[**Most Favored Nation Status**](https://www.thebalance.com/most-favored-nation-status-3305840)**confers the best trading terms a nation can get from a trading partner. Developing countries benefit the most from this trading status.**

·         The second benefit is that**it increases trade for every participant.** Their companies enjoy **low tariffs**. That makes their **exports cheaper**.

·         The third benefit is it **standardizes commerce regulations** for all the trade partners. Companies save legal costs since they follow the same rules for each country.

·         The fourth benefit is that countries can **negotiate trade deals with more than one country** at a time. Trade agreements undergo a detailed approval process. Most countries would prefer to get one agreement ratified covering many countries at once.

·         The fifth benefit applies to emerging markets. **Bilateral trade agreements tend to favor the country with the best economy. That puts the weaker nation at a disadvantage**. But making emerging markets stronger helps the developed economy over time.

As those emerging markets become developed, their **middle class population increases**. That creates new affluent customers for everyone.

**4 Disadvantages of multilateral trading**

·         The biggest disadvantage of multilateral agreements is that **they are complex**. That makes them difficult and **time consuming to negotiate**. Sometimes the length of negotiation means it won't take place at all.

·         Second, the details of the negotiations are particular to trade and business practices. The public often misunderstands them. As a result**, they receive lots of press, controversy, and protests**.

·         The third disadvantage is common to any trade agreement. Some companies and regions of the **country suffer when trade borders disappear.**

·         The fourth disadvantage falls on a country's small businesses. **A multilateral agreement gives a competitive advantage to giant multi-nationals.** They are already familiar with operating in a global environment. As a result, the small firms can't compete. They lay off workers to cut costs. Others move their factories to countries with a lower standard of living. If a region depended on that industry, it would experience **high unemployment rates**. That makes multilateral agreements unpopular.

**Pros**

* **Treats all member nations equally.**
* **Makes international trading easier.**
* **Trade regulations are the same for everyone.**
* **Helps emerging markets.**
* **Multiple nations are covered by one treaty.**

**Cons**

* **Negotiations can be lengthy, risk breaking down.**
* **Easily misunderstood by the public**
* **Removing trade borders affects businesses.**
* **Benefits large corporations, but not small businesses.**

Examples

Some regional trade agreements are multilateral. The largest had been the [North American Free Trade Agreement](https://www.thebalance.com/facts-about-nafta-statistics-and-accomplishments-3306280) (NAFTA), which was ratified on January 1, 1994. NAFTA quadrupled trade between the United States, Canada, and Mexico from its 1993 level to 2018. On July 1, 2020, the U.S.-Mexico-Canada Agreement (USMCA) went into effect. The USMCA was a new trade agreement between the three countries that was negotiated under President Donald Trump.

The Central American-Dominican Republic Free Trade Agreement was signed on August 5, 2004. CAFTA-DR eliminated tariffs on more than 80% of U.S. exports to six countries: Costa Rica, the Dominican Republic, Guatemala, Honduras, Nicaragua, and El Salvador.﻿ As of November 2019, it had increased trade by 104%, from $2.44 billion in January 2005 to $4.97 billion.

The [**Trans-Pacific Partnership**](https://www.thebalance.com/what-is-the-trans-pacific-partnership-3305581)**would have been bigger than**[**NAFTA**](https://www.thebalance.com/facts-about-nafta-statistics-and-accomplishments-3306280). Negotiations concluded on October 4, 2015. **After becoming president, Donald Trump withdrew from the agreement. He promised to replace it with bilateral agreements.** The TPP was between the United States and 11 other countries bordering the Pacific Ocean. It would have removed tariffs and standardized business practices.

All global trade agreements are multilateral. The most successful one is the General Agreement on Trade and Tariffs. Twenty-three countries signed GATT in 1947. Its goal was to reduce tariffs and other trade barriers.

In September 1986, the Uruguay Round began in Punta del Este, Uruguay. It centered on extending trade agreements to several new areas. These included services and intellectual property. It also improved trade in agriculture and textiles. The Uruguay Round led to the creation of the [World Trade Organization](https://www.thebalance.com/what-is-the-world-trade-organization-wto-3306366). **On April 15, 1994, the 123 participating governments signed the agreement creating the WTO in Marrakesh, Morocc**o. **The WTO assumed management of future global multilateral negotiations.**

The WTO's first project was the [Doha round of trade agreements](https://www.thebalance.com/what-is-the-doha-round-of-trade-talks-3306365) in 2001.﻿ That was a multilateral trade agreement among all WTO members. Developing countries would allow imports of financial services, particularly banking. In so doing, they would have to modernize their markets. In return, the developed countries would reduce farm subsidies. That would boost the growth of developing countries that were good at producing food.

Farm lobbies in the United States and the [European Union](https://www.thebalance.com/what-is-the-european-union-how-it-works-and-history-3306356) doomed Doha negotiations.﻿ They refused to agree to lower subsidies or accept increased foreign competition. The WTO abandoned the Doha round in July 2008.

On December 7, 2013, WTO representatives agreed to the so-called Bali package. All countries agreed to streamline customs standards and reduce red tape to expedite trade flows. Food security is an issue. India wants to subsidize food so it could stockpile it to distribute in case of famine. Other countries worry that India may dump the cheap food in the global market to gain market share.

In class exercise

Question 1: What is the primary focus of multilateral trade agreements?

a) Commerce treaties among three or more nations

b) Commerce treaties between two nations

c) Bilateral agreements for economic growth

**Answer: A**

**Explanation:** Multilateral trade agreements involve commerce treaties among three or more nations to reduce tariffs and ease import-export processes.

Question 2: Why are multilateral agreements considered more robust than bilateral agreements?

a) They are easier to negotiate

b) They involve many countries and are difficult to negotiate

c) They have a smaller impact on economic growth

**Answer: B**

**Explanation:** The broad scope of multilateral agreements involving many countries makes them more robust.

Question 3: What advantage do multilateral agreements provide for emerging market countries?

a) Exclusivity in trade deals

b) Most Favored Nation Status and equal treatment

c) Preferential treatment for smaller economies

**Answer: B**

**Explanation:** Multilateral agreements ensure equal treatment among signatories, benefiting emerging market countries.

Question 4: How do multilateral agreements impact trade for participants?

a) They decrease trade for participants

b) They have no impact on trade dynamics

c) They increase trade by providing low tariffs

**Answer: C**

**Explanation:** Participants in multilateral agreements enjoy low tariffs, making their exports cheaper and increasing trade.

Question 5: Why do countries prefer negotiating trade deals with more than one country at a time?

a) Faster approval process

b) Detailed approval process for one agreement covering many countries at once

c) Avoidance of trade negotiations

**Answer: B**

**Explanation:** Negotiating one agreement covering many countries at once is preferred due to the detailed approval process.

Question 6: What is the significance of emerging markets becoming stronger in the context of multilateral agreements?

a) Creates new affluent customers and benefits the developed economy over time

b) No impact on developed economies

c) Weakens the developed economy

**Answer: A**

**Explanation:** Strengthening emerging markets creates new affluent customers, benefiting the developed economy over time.

Question 7: What is the biggest disadvantage of multilateral agreements mentioned in the video?

a) They are easily understood by the public

b) They are complex and time-consuming to negotiate

c) They have a minimal impact on businesses

**Answer: B**

**Explanation:** The complexity of multilateral agreements makes them difficult and time-consuming to negotiate.

Question 8: Why do negotiations of multilateral agreements often receive press, controversy, and protests?

a) Lack of public interest

b) Smooth negotiation process

c) Public misunderstanding due to particular trade details

**Answer: C**

**Explanation:** Public misunderstanding of trade details leads to press, controversy, and protests.

Question 9: What is a common consequence when trade borders disappear?

a) No impact on businesses

b) Some companies and regions suffer

c) Enhanced business opportunities

**Answer: B**

**Explanation:** When trade borders disappear, some companies and regions may suffer due to increased competition.

Question 10: Which entities benefit the most from multilateral agreements, creating a competitive advantage?

a) Giant multi-nationals

b) Small businesses

c) Medium-sized enterprises

**Answer: A**

**Explanation:** Multilateral agreements give a competitive advantage to giant multi-nationals, which are familiar with global operations.

Question 11: What does the video suggest about the impact of multilateral agreements on small businesses?

a) They gain a competitive advantage

b) They experience high unemployment rates

c) They become globally competitive

**Answer: B**

**Explanation:** Small businesses may face challenges and lay off workers due to the competitive advantage given to larger corporations.

Question 12: What is the primary benefit of the Most Favored Nation Status in multilateral agreements?

a) Exclusive trade deals for a single country

b) Tariff reductions for developed economies

c) Best trading terms a nation can get from a trading partner

**Answer: C**

**Explanation:** Most Favored Nation Status confers the best trading terms a nation can get from a trading partner.

1. What Is Bilateral Trade?

**Bilateral trade is the exchange of goods between two nations promoting trade and investment.** **The two countries will reduce or eliminate tariffs, import quotas, export restraints, and other trade barriers to encourage trade and investment.**

In the United States, the Office of Bilateral Trade Affairs minimizes trade deficits through negotiating free trade agreements with new countries, supporting and improving existing trade agreements, promoting economic development abroad, and other actions.

KEY TAKEAWAYS

·       Bilateral trade agreements are agreements between countries to promote trade and commerce.

·       They eliminate trade barriers such as tariffs, import quotas, and export restraints in order to encourage trade and investment.

·       The main advantage of bilateral trade agreements is an expansion of the market for a country's goods through concerted negotiation between two countries.

·       **Bilateral trade agreements can also result in the closing down of smaller companies unable to compete with large multinational corporations.**

Understanding Bilateral Trade

The goals of bilateral trade agreements are to expand access between two countries’ markets and increase their economic growth. Standardized business operations in five general areas prevent one country from stealing another’s innovative products, dumping goods at a small cost, or using unfair subsidies. **Bilateral trade agreements standardize regulations, labor standards, and environmental protections.**

**The United States has signed bilateral trade agreements with 20 countries,** some of which include Israel, Jordan, Australia, Chile, Singapore, Bahrain, Morocco, Oman, Peru, Panama, and Colombia.

Advantages and Disadvantages of Bilateral Trade

Compared to multilateral trade agreements, **bilateral trade agreements are negotiated more easily, because only two nations are party to the agreement. Bilateral trade agreements initiate and reap trade benefits faster than multilateral agreements.**

Examples of Bilateral Trade

<https://policy.trade.ec.europa.eu/eu-trade-relationships-country-and-region/countries-and-regions/united-states_en>

The European Union and the United States **have the largest bilateral trade and investment relationship and enjoy the most integrated economic relationship in the world.** Although overtaken by China in 2020 as the largest trading partner specifically for goods, when services and investment are taken into account, the US remains the EU’s largest trading partner by far.

The transatlantic relationship is a key artery of the world economy. Either the EU or the US is the largest trade and investment partner of almost every other country in the global economy. Taken together, the economies of both territories account for one third of global trade in goods and services and close to one third of world GDP in terms of purchasing power.

Trade picture

·       Bilateral trade and investment support millions of jobs in the EU and the US. Around 9.4 million people are directly employed. Indirectly, as many as 16 million jobs on both sides of the Atlantic are supported.

·       The EU-US trade and investment relationship remains strong despite the economic challenges related to the Covid-19 pandemic.

·       Transatlantic trade reached an all-time high of 1.2 trillion euro in 2021, surpassing pre-pandemic levels by more than 10%.

·       The United States remains the EU’s number one trading partner in services. Bilateral trade in services reached a record in 2021 and accounted for more than 500 billion euro.

·       The size of trade in services and goods between the EU and the US is matched by their mutual investments, which are the biggest in the world and which are a substantial driver of the transatlantic relationship.

·       Total US investment in the EU is four times higher than in the Asia-Pacific region. EU foreign direct investment in the US is around 10 times the amount of EU investment in India and China together.

·       Total investment includes foreign direct investment, where the EU and the US are each other’s biggest sources. In 2020, the EU registered €2.1 trillion in outward stock, and €2.3 trillion in inward stock.

·       The transatlantic relationship is a key feature of the overall global economy and trade flows. For most countries, either the EU or the US is the largest trade and investment partner.

 





<https://ec.europa.eu/eurostat/statistics-explained/index.php?title=USA-EU_-_international_trade_in_goods_statistics>

In class exercise

Question 1: What is bilateral trade?

A) The exchange of goods between two nations

B) The exchange of goods within a single nation

C) The exchange of goods in a multilateral setting

**Answer: A**

**Explanation:** Bilateral trade involves the exchange of goods between two nations.

Question 2: What do bilateral trade agreements aim to achieve?

A) Increase trade barriers

B) Standardize business operations

C) Encourage competition

**Answer: B**

**Explanation:** Bilateral trade agreements aim to standardize business operations and eliminate trade barriers.

Question 3: What is a key advantage of bilateral trade agreements?

A) Slower negotiation process

B) Faster initiation and benefits

C) Increased competition

**Answer: B**

**Explanation:** Bilateral trade agreements initiate and reap trade benefits more quickly compared to multilateral agreements.

Question 4: How do bilateral trade agreements affect smaller companies?

A) Promote their growth

B) Have no impact

C) May lead to closure due to competition

**Answer: C**

**Explanation:** Bilateral trade agreements can result in the closing down of smaller companies unable to compete with large multinational corporations.

Question 5: Which areas do bilateral trade agreements standardize?

A) Regulatory standards, labor standards, and environmental protections

B) Marketing strategies and pricing

C) Technology and innovation

**Answer: A**

**Explanation:** Bilateral trade agreements standardize regulations, labor standards, and environmental protections.

Question 6: Which country has signed bilateral trade agreements with 20 nations, including Israel and Jordan?

A) China

B) United States

C) European Union

**Answer: B**

**Explanation:** The United States has signed bilateral trade agreements with various countries, including Israel and Jordan.

Question 7: How do bilateral trade and investment support jobs in the EU and the US?

A) 9.4 million jobs directly employed

B) No significant impact on employment

C) Decrease in job opportunities

**Answer: A**

**Explanation:** Bilateral trade and investment support around 9.4 million jobs directly employed in the EU and the US.

Question 8: What is a key feature of the transatlantic relationship in terms of trade and investment flows?

A) Least influential in the global economy

B) Mutual investments being the smallest in the world

C) Either the EU or the US is the largest trade and investment partner for most countries

**Answer: C**

**Explanation**: Either the EU or the US is the largest trade and investment partner for most countries, making it a key feature of the transatlantic relationship.

By THE INVESTOPEDIA TEAM,  Updated June 29, 2021, Reviewed by ROBERT C. KELLY

<https://www.investopedia.com/ask/answers/031615/whats-difference-between-current-account-and-capital-account.asp>

1. Current vs. Capital Accounts: An Overview

The current and capital accounts represent two halves of a nation's balance of payments. **The current account represents a country's net income over a period of time, while the capital account records the net change of assets and liabilities during a particular year.**

In economic terms, the current account deals with the receipt and payment in cash as well as non-capital items, while the capital account reflects sources and utilization of capital. The **sum of the current account and capital account reflected in the balance of payments will always be zero. Any surplus or deficit in the current account is matched and canceled out by an equal surplus or deficit in the capital account**.

KEY TAKEAWAYS

·       The current and capital accounts are two components of a nation's balance of payments.

·       The current account is the difference between a country's savings and investments.

·       A country's capital account records the net change of assets and liabilities during a certain period of time.

**Current Account**

The current account deals with a country's short-term transactions or the difference between its savings and investments. These are also referred to as actual transactions (as they have a real impact on income), output and employment levels through the movement of goods and services in the economy.

The **current account consists of visible trade (export and import of goods), invisible trade (export and import of services**), unilateral transfers, and investment income (income from factors such as land or foreign shares). The credit and debit of foreign exchange from these transactions are also recorded in the balance of the current account. The resulting balance of the current account is approximated as the sum total of the balance of trade.

**Current Account vs. Capital Account**

Transactions are recorded in the current account in the following ways:

**Exports are noted as credits in the balance of payments**

**Imports are recorded as debits in the balance of payments**

The current account gives economists and other analysts an idea of how the country is faring economically. **The difference between exports and imports, or the trade balance, will determine whether a country's current balance is positive or negative. When it is positive, the current account has a surplus, making the country a "net lender" to the rest of the world. A deficit means the current account balance is negative. In this case, that country is considered a net borrower.**

If imports decline and exports increase to stronger economies during a recession, the country's current account deficit drops. But if exports stagnate as imports grow when the economy grows, the current account deficit grows.

**Capital Account**

**The capital account is a record of the inflows and outflows of capital that directly affect a nation’s foreign assets and liabilities**. It is concerned with all international trade transactions between citizens of one country and those in other countries.

The components of the capital account include foreign investment and loans, banking, and other forms of capital, as well as monetary movements or changes in the foreign exchange reserve. The capital account flow reflects factors such as commercial borrowings, banking, investments, loans, and capital.

**A surplus in the capital account means there is an inflow of money into the country, while a deficit indicates money moving out of the country**. In this case, the country may be increasing its foreign holdings.

In other words, the capital account is concerned with payments of debts and claims, regardless of the time period. The balance of the capital account also includes all items reflecting changes in stocks.

 **The International Monetary Fund divides capital account into two categories: The financial account and the capital account.**

The term capital account is also used in accounting. It is a general ledger account used to record the contributed capital of corporate owners as well as their retained earnings. These balances are reported in a balance sheet's shareholder's equity section.

[**Balance of payments: Current account (video, Khan academy)**](https://www.khanacademy.org/economics-finance-domain/macroeconomics/forex-trade-topic/macro-the-balance-of-payments/v/balance-of-payments-current-account)

In class exercise

1.     What is the focus of the current account in the balance of payments?

A) Imports and exports

B) Changes in ownership of assets

C) Net transfers

**Answer: A**

**Explanation:** The current account focuses on trade, including imports and exports.

2.     What is the result if the current account calculation shows a positive number?

A) Current account surplus

B) Trade deficit

C) Net transfers deficit

**Answer: A**

**Explanation**: A positive current account indicates a surplus.

3.     What is the primary reason for the U.S. running a current account deficit in this scenario?

A) High net transfers

B) Excessive exports

C) Trade deficit and income payments to foreign-owned assets

**Answer: C**

**Explanation:** The U.S. runs a deficit due to a trade deficit and payments on foreign-owned assets.

4.     Which factor indicates an outflow of currency from the U.S.?

A) Exports

B) Income on U.S. assets abroad

C) Net transfers deficit

**Answer: C**

**Explanation**: Net transfers deficit represents an outflow of currency.

5.     What is the primary focus of the current account in a nation's balance of payments?

A) Changes in foreign assets and liabilities

B) Net change of assets and liabilities

C) Net income over a period of time

**Answer: C**

**Explanation:** The current account represents a country's net income over a period of time.

6.     How is the balance of the current account and capital account related in the balance of payments?

A) They are independent and unrelated

B) Their sum is always zero

C) Capital account surplus cancels out current account deficit

**Answer: B**

**Explanation:** The sum of the current account and capital account in the balance of payments is always zero.

7.     What are components of the current account?

A) Visible trade, invisible trade, unilateral transfers, and investment income

B) Foreign investments and loans

C) Monetary movements and changes in foreign exchange reserves

**Answer: A**

**Explanation:** Components of the current account include visible trade, invisible trade, unilateral transfers, and investment income.

8.     How are exports and imports recorded in the balance of payments under the current account?

A) Both are recorded as debits

B) Exports are credits, and imports are debits

C) Both are recorded as credits

**Answer: B**

**Explanation:** Exports are noted as credits, and imports are recorded as debits in the balance of payments.

9.     What does a positive trade balance in the current account indicate?

A) Current account deficit

B) Net borrower status

C) Current account surplus

**Answer: C**

**Explanation:** A positive trade balance indicates a current account surplus.

10.  What does a surplus in the capital account represent?

A) Inflow of money into the country

B) Net borrower status

C) Outflow of money from the country

**Answer: A**

**Explanation:** A surplus in the capital account indicates an inflow of money into the country.

11.  What does a deficit in the capital account signify?

A) Inflow of money into the country

B) Outflow of money from the country

C) Balanced capital account

**Answer: B**

**Explanation:** A deficit in the capital account signifies an outflow of money from the country.

12.  How does the capital account differ from the current account in terms of the time period considered?

A) Capital account focuses on short-term transactions

B) Both accounts consider the same time period

C) Capital account is concerned with long-term changes

**Answer: C**

**Explanation:** The capital account is concerned with long-term changes in assets and liabilities.

13. What components does the capital account include?

A) Foreign investments and loans

B) Changes in stocks

C) Monetary movements and changes in reserves

**Answer: A**

**Explanation:** Components of the capital account include foreign investments and loans.

14. How is the balance of the capital account related to surplus and deficit?

A) Surplus indicates a deficit in the capital account

B) Surplus indicates an inflow of money into the country

C) Deficit indicates a current account surplus

**Answer: B**

**Explanation:** Surplus indicates an inflow of money into the country.

15. How are deficits and surpluses balanced in the balance of payments?

A) Surplus in the current account balances deficit in the capital account

B) Equal surpluses in both accounts

C) Equal deficits in both accounts

**Answer: A**

**Explanation:** Surplus in the current account balances deficit in the capital account.

16. What does a current account deficit imply about a country's economic status?

A) Net lender status

B) Economic recession

C) Net borrower status

**Answer: C**

**Explanation:** A current account deficit implies that the country is a net borrower.

17. What is the relationship between the balance of trade and the current account?

A) They are independent

B) Balance of trade is a subset of the current account

C) Current account is a subset of the balance of trade

**Answer: B**

**Explanation:** The resulting balance of the current account is approximated as the sum total of the balance of trade.

18. How are income receipts from factors like land or foreign shares accounted for in the current account?

A) As credits

B) As debits

C) As net transfers

**Answer: A**

**Explanation:** Income receipts from factors like land or foreign shares are accounted for as credits in the current account.

19. What determines whether a country is a net lender or net borrower based on the current account?

A) Net income over a short period

B) Difference between exports and imports

C) Balance of trade

**Answer: B**

**Explanation:** The difference between exports and imports determines whether a country is a net lender or net borrower based on the current account.

20. How is a deficit in the current account balanced in the balance of payments?

A) With a surplus in the capital account

B) By increasing net transfers

C) By increasing exports

**Answer: A**

**Explanation:** A deficit in the current account is matched and canceled out by a surplus in the capital account.

21. What does a capital account deficit indicate?

A) Inflow of money into the country

B) Outflow of money from the country

C) Balanced capital account

**Answer: B**

**Explanation:** A capital account deficit indicates an outflow of money from the country.

 [**4. Finance: The History of Money (combined) (video, fan to watch)**](https://www.youtube.com/watch?v=YCN2aTlocOw)

**In class exercise**

1. What was one of the challenges faced by early communities as they engaged in more numerous exchanges?

A) Keeping track of taxes

B) Maintaining a record of payments and receipts

C) Enforcing IOU notes

**Answer: B**

**Explanation:** As communities grew and exchanges became more numerous, it became increasingly hard to keep track of payments and receipts.

2. What was one of the characteristics of barley that made it unsuitable as a form of money?

A) It was easily divisible

B) It was portable

C) It was heavy to carry

**Answer: C**

**Explanation:** Barley, being heavy to carry, was not portable or even durable, making it unsuitable as a form of money.

3. What was a noticeable feature of metal money that made it appealing for trade?

A) Lack of intrinsic value

B) Ease of forgery

C) Intrinsic value and durability

**Answer: C**

**Explanation:** Metal money had intrinsic value due to the precious metals used, and it was durable, making it suitable for trade.

4. What was the innovation introduced by early Chinese rulers to facilitate long-distance trading?

A) IOU certificates on paper

B) Minted coins

C) Barley as currency

**Answer: A**

**Explanation:** Early Chinese rulers issued IOU certificates on paper for long-distance trading, allowing traders to carry around lighter certificates instead of heavy coins.

5. What did traders and lenders attempt to link the value of paper money to?

A) Value of gold

B) Value of shells

C) Value of feathers

**Answer: A**

**Explanation:** Traders and lenders attempted to link the value of paper money to the value of gold to create a standard for exchange between different currencies.

6. What significant event caused the American War of Independence, according to Benjamin Franklin?

A) Disadvantageous trade with Britain

B) Burden of British taxation

C) Forced use of pounds for taxes

**Answer: B**

**Explanation:** Benjamin Franklin attributed the American War of Independence to the burden of British taxation and disadvantageous trade.

7. What practice allowed banks to lend out more money than they had on deposit?

A) Fractional reserve banking

B) Full reserve banking

C) Gold standard banking

**Answer: A**

**Explanation:** Fractional reserve banking allowed banks to lend out more money than they had on deposit by only keeping a fraction of deposits as reserves.

8. What action did the government take to prevent runs on banks in the 19th century?

A) Increased interest rates

B) Ensured customers' deposits

C) Reduced reserve requirements

**Answer: B**

**Explanation:** The government ensured customers' deposits to prevent runs on banks in the 19th century, thereby restoring confidence in the banking system.

9. What event marked the disappearance of the gold standard in 1973?

A) Adoption of the euro

B) Signing of the Bretton Woods Agreement

C) Last traces of the gold standard

**Answer: C**

**Explanation:** The last traces of the gold standard disappeared in 1973, marking a significant shift in monetary policy.

10. What characteristic of bitcoin challenges the power of government-backed money?

A) Portability

B) Divisibility

C) Limited supply

**Answer: C**

**Explanation**: Bitcoin, with their limited supply, challenge the power of government-backed money, as they are not subject to government control over money supply.

**5. Bretton Woods Agreement and System**

By JAMES CHEN Updated April 28, 2021, Reviewed by SOMER ANDERSON

<https://www.investopedia.com/terms/b/brettonwoodsagreement.asp#:~:text=The%20Bretton%20Woods%20System%20required,the%20IMF%20and%20World%20Bank>.

What Was the Bretton Woods Agreement and System?

**The Bretton Woods Agreement was negotiated in July 1944 by delegates from 44 countries** at the United Nations Monetary and Financial Conference held in Bretton Woods, New Hampshire. Thus, the name “Bretton Woods Agreement.﻿”

Under the Bretton Woods System, gold **was the basis for the U.S. dollar and other currencies were pegged to the U.S. dollar’s value**. **The Bretton Woods System effectively came to an end in the early 1970s when President Richard M. Nixon announced that the U.S. would no longer exchange gold for U.S. currency.**

The Bretton Woods Agreement and System Explained

Approximately 730 delegates representing 44 countries met in **Bretton Woods in July 1944 with the principal goals of creating an efficient foreign exchange system, preventing competitive devaluations of currencies, and promoting international economic growth. The Bretton Woods Agreement and System were central to these goals. The Bretton Woods Agreement also created two important organizations—the International Monetary Fund (IMF) and the World Bank.** While the Bretton Woods System was dissolved in the 1970s, both the IMF and World Bank have remained strong pillars for the exchange of international currencies.

Though the Bretton Woods conference itself took place over just three weeks, the preparations for it had been going on for several years. The primary designers of the Bretton Woods System were the famous British economist John Maynard Keynes and American Chief International Economist of the U.S. Treasury Department Harry Dexter White. Keynes’ hope was to establish a powerful global central bank to be called the Clearing Union and issue a new international reserve currency called the bancor. White’s plan envisioned a more modest lending fund and a greater role for the U.S. dollar, rather than the creation of a new currency. In the end, the adopted plan took ideas from both, leaning more toward White’s plan.﻿

**It wasn't until 1958 that the Bretton Woods System became fully functional**. Once implemented, its provisions called for the U.S. dollar to be pegged to the value of gold. Moreover, all other currencies in the system were then pegged to the U.S. dollar’s value. **The exchange rate applied at the time set the price of gold at $35 an ounce.**

KEY TAKEAWAYS

·       The Bretton Woods Agreement and System created a collective international currency exchange regime that lasted from the mid-1940s to the early 1970s.

·       The Bretton Woods System required a currency peg to the U.S. dollar which was in turn pegged to the price of gold.

·       The Bretton Woods System collapsed in the 1970s but created a lasting influence on international currency exchange and trade through its development of the IMF and World Bank.

**Benefits** of Bretton Woods Currency Pegging

The Bretton Woods System included 44 countries. These countries were brought together to help regulate and promote international trade across borders. As with the benefits of all currency pegging regimes, currency pegs are expected **to provide currency stabilization for trade of goods and services as well as financing**.

All of the countries in the Bretton Woods System agreed to a fixed peg against the U.S. dollar with diversions of only 1% allowed. Countries were required to monitor and maintain their currency pegs which they achieved primarily by using their currency to buy or sell U.S. dollars as needed. **The Bretton Woods System, therefore, minimized international currency exchange rate volatility which helped international trade relations.**More stability in foreign currency exchange was also a factor for the successful support of loans and grants internationally from the World Bank.

The IMF and World Bank

The Bretton Woods Agreement created two Bretton Woods Institutions, the IMF and the World Bank. Formally introduced in December 1945 both institutions have withstood the test of time, globally serving as important pillars for international capital financing and trade activities.

The purpose of the IMF was to monitor exchange rates and identify nations that needed global monetary support. The World Bank, initially called the International Bank for Reconstruction and Development, was established to manage funds available for providing assistance to countries that had been physically and financially devastated by World War II.1﻿ In the twenty-first century, the IMF has 189 member countries and still continues to support global monetary cooperation. Tandemly, the World Bank helps to promote these efforts through its loan**s and grants to governments.2﻿**

**The Bretton Woods System’s Collapse**

**In 1971, concerned that the U.S. gold supply was no longer adequate to cover the number of dollars in circulation, President Richard M. Nixon devalued the U.S. dollar relative to gold. After a run on gold reserve, he declared a temporary suspension of the dollar’s convertibility into gold. By 1973 the Bretton Woods System had collapsed.**Countries were then free to choose any exchange arrangement for their currency, except pegging its value to the price of gold. They could, for example, link its value to another country's currency, or a basket of currencies, or simply let it float freely and allow market forces to determine its value relative to other countries' currencies.

The Bretton Woods Agreement remains a significant event in world financial history. The two Bretton Woods Institutions it created in the International Monetary Fund and the World Bank played an important part in helping to rebuild Europe in the aftermath of World War II. ﻿ Subsequently, both institutions have continued to maintain their founding goals while also transitioning to serve global government interests in the modern-day.

In class exercise

1.               What was the primary goal of the Bretton Woods Agreement?

A) Establishing a global central bank

B) Preventing competitive devaluations of currencies

C) Creating a new international reserve currency

**Answer: B**

**Explanation:** The primary goal of the Bretton Woods Agreement, was to prevent competitive devaluations of currencies.

2.               Who were the principal designers of the Bretton Woods System?

A) John Maynard Keynes and Harry Dexter White

B) Richard M. Nixon and John F. Kennedy

C) Franklin D. Roosevelt and Winston Churchill

**Answer: A**

**Explanation:** The principal designers of the Bretton Woods System were John Maynard Keynes and Harry Dexter White.

3.               What were the two organizations created by the Bretton Woods Agreement?

A) International Monetary Fund (IMF) and World Bank

B) World Trade Organization (WTO) and United Nations (UN)

C) European Union (EU) and NATO

**Answer: A**

**Explanation**: The Bretton Woods Agreement created the International Monetary Fund (IMF) and the World Bank.

4.               When did the Bretton Woods System become fully functional?

A) 1944

B) 1958

C) 1971

**Answer: B**

**Explanation**: The Bretton Woods System became fully functional in 1958.

5.               What was the basis for the U.S. dollar under the Bretton Woods System?

A) Silver

B) Oil

C) Gold

**Answer: C**

**Explanation:** Gold was the basis for the U.S. dollar under the Bretton Woods System.

6.               What event marked the collapse of the Bretton Woods System?

A) President Nixon's announcement of gold exchange suspension

B) The establishment of the IMF and World Bank

C) The adoption of the euro as a common currency

**Answer: A**

**Explanation**: President Nixon's announcement of suspending the gold exchange marked the collapse of the Bretton Woods System.

7.               What was the primary function of the IMF?

A) Providing loans and grants to governments

B) Promoting international trade across borders

C) Monitoring exchange rates and providing global monetary support

**Answer: C**

**Explanation**: The primary function of the IMF was to monitor exchange rates and provide global monetary support.

8.               What was the initial purpose of the World Bank?

A) Supporting international trade activities

B) Managing funds for post-war reconstruction

C) Facilitating currency stabilization

**Answer: B**

**Explanation:** The initial purpose of the World Bank was to manage funds for post-war reconstruction.

9.               How many member countries does the IMF have in the twenty-first century?

A) 44

B) 189

C) 73

**Answer: B**

**Explanation:** In the twenty-first century, the IMF has 189 member countries.

10.            How did countries in the Bretton Woods System maintain their currency pegs?

A) By using their currency to buy or sell U.S. dollars

B) By buying or selling gold

C) By floating their currency freely

**Answer: A**

**Explanation:** Countries in the Bretton Woods System maintained their currency pegs by using their currency to buy or sell U.S. dollars.

11.            What did President Nixon do in response to concerns about the adequacy of the U.S. gold supply?

A) Suspended the convertibility of the dollar into gold

B) Increased gold reserves

C) Devalued the U.S. dollar

**Answer: A**

**Explanation:** President Nixon suspended the convertibility of the dollar into gold in response to concerns about the adequacy of the U.S. gold supply.

12.            How did the Bretton Woods Agreement contribute to international trade relations?

A) By promoting currency devaluations

B) By limiting international capital financing

C) By minimizing currency exchange rate volatility

**Answer: C**

**Explanation:** The Bretton Woods Agreement contributed to international trade relations by minimizing currency exchange rate volatility.

13. What was the significance of the IMF and World Bank created by the Bretton Woods Agreement?

A) They facilitated currency pegging to gold

B) They supported global monetary cooperation and post-war reconstruction

C) They promoted competitive devaluations of currencies

**Answer: B**

**Explanation:** The IMF and World Bank created by the Bretton Woods Agreement supported global monetary cooperation and post-war reconstruction.

14. What option did countries have regarding their exchange arrangement after the collapse of the Bretton Woods System?

A) Pegging their currency to the price of gold

B) Letting their currency float freely

C) Linking their currency value to the U.S. dollar

**Answer: B**

**Explanation**: After the collapse of the Bretton Woods System, countries were free to let their currency float freely.

[6. What Are Currency Pairs? (youtube)](https://www.youtube.com/watch?v=b0PpzEuCc9A)

1. What is the base currency in the Euro/US Dollar currency pair?

a) US Dollar

b) Euro

c) Swiss Franc

**Answer: b**

**Explanation:** In the Euro/US Dollar pair, the Euro is the base currency. This means that the exchange rate indicates how many US Dollars are needed to buy one Euro.

2. Which currency pair tends to have a negative correlation with the US Dollar/Swiss Franc pairing?

a) Euro/US Dollar

b) British Pound/US Dollar

c) US Dollar/Swiss Franc

**Answer: a**

**Explanation:** The Euro/US Dollar pair tends to have a negative correlation with the US Dollar/Swiss Franc pair. This means that as one pair moves up, the other tends to move in the opposite direction.

3. What is the commonly used term for trading the US Dollar/Japanese Yen pair?

a) Cable

b) Swissy

c) Gopher

**Answer: c**

**Explanation:** The US Dollar/Japanese Yen pair is often referred to as "trading the gopher" in forex trading slang.

4. Which currency pair usually exhibits a positive correlation with the Euro/US Dollar?

a) US Dollar/Swiss Franc

b) British Pound/US Dollar

c) Euro/US Dollar

**Answer: b**

**Explanation**: The British Pound/US Dollar pair usually exhibits a positive correlation with the Euro/US Dollar pair.

5. What is the nickname for the British Pound/US Dollar pairing?

a) Cable

b) Gopher

c) Swissy

**Answer: a**

**Explanation:** The British Pound/US Dollar pairing is commonly referred to as "trading the cable" in forex trading.

6. What currency is considered a safe haven during times of political unrest?

a) US Dollar

b) Euro

c) Swiss Franc

**Answer: c**

**Explanation:** The Swiss Franc is often considered a safe haven currency during periods of political instability.

**7. Quote Currency in Forex: Meaning and Examples**

<https://www.investopedia.com/terms/q/quotecurrency.asp>

**By ADAM HAYES Updated May 25, 2022 Reviewed by GORDON SCOTT Reviewed by Gordon Scott**

**What Is a Quote Currency?**

**In foreign exchange (forex), the quote currency, commonly known as the counter currency, is the second currency in both a direct and indirect currency pair and is used to determine the value of the base currency.**

**In a direct quote, the quote currency is the foreign currency, while in an indirect quote, the quote currency is the domestic currency.** The quote currency is listed after the base currency in the pair when currency exchange rates are quoted. One can determine how much of the quote currency they need to sell in order to purchase one unit of the first or base currency.

**KEY TAKEAWAYS**

·       The quote currency (counter currency) is the second currency in both a direct and indirect currency pair and is used to value the base currency.

·       Currency quotes show many units of the quote currency they will need to exchange for one unit of the first (base) currency.

·       In a direct quote, the quote currency is the foreign currency, while in an indirect quote, the quote currency is the domestic currency.

·       When somebody buys (goes long) a currency pair, they sell the counter currency; if they short a currency pair, they would buy the counter currency.

**Understanding Quote Currency**

Understanding the quotation and pricing structure of currencies is essential for anyone wanting to trade currencies in the forex market. Market makers tend to trade specific currency pairs in set ways, either direct or indirect, which means understanding the quote currency is paramount.

A currency pair's exchange rate reflects how much of the quote currency is needed to be sold/bought to buy/sell one unit of the base currency. As the rate in a currency pair increases, the value of the quote currency falls, whether the pair is direct or indirect.

Most U.S. dollar (USD) pairs hold the USD as the base currency. If the USD is not the base, it is a reciprocal currency.

For example, the cross rate between the U.S. dollar and the Canadian dollar is denoted as USD/CAD and is a direct quote. This means that the CAD is the quote currency, while the USD is the base currency. The CAD is used as a reference to determine the value of one USD. From a U.S.-centric point of view, the CAD is a foreign currency.

On the other hand, the EUR/USD denotes the cross rate between the euro and the U.S. dollar and is an indirect quote. This means that the EUR is the base currency, and the USD is the quote currency. Here, the USD is the domestic currency and determines the value of one EUR.

**Special Considerations**

Currency pairs—both base and quote currencies—are affected by a number of different factors. Some of these include economic activity, the monetary and fiscal policy enacted by central banks, and interest rates.

Major currencies, such as the euro and U.S. dollar, are more likely to be the base currency rather than the quote currency in a currency pair, especially when it comes to trades in exotic currencies.

The most commonly traded currency pairs on the market in 2021 were:

EUR/GBP

EUR/USD

GBP/USD

USD/CHF

USD/JPY

As noted above, the first currency in these pairings is the base currency while the second one (after the slash) is the quote currency. In the GBP/USD pairing, the pound is the base currency or the one that is being purchased while the dollar is the quote currency. This is the one that is being sold.

**Example of a Quote Currency**

Let's assume a trader wants to purchase £400 using U.S. dollars. This would involve a trade using the GBP/USD currency pair. In order to execute the trade, they need to figure out how many USD (the quote currency) they need to sell in order to get £400.

The exchange rate for the pair at the end of the trading day on June 3, 2021, was 1.4103. This means it cost the trader $1.4103 to purchase £1. To complete the transaction on that day, the trader had to sell 564.12 units of the quote currency in order to get 400 units of the base currency or $564.12 for £400 = (400 x 1.4103).

Summary:

╔═════════════════════════════╗

║                        Currency Exchange Rates                 ║

║ Indirect Quote: EUR/USD                           ║

║ ------------------------------------------------------------ ║

║ **Base** Currency:       Euro (EUR)                             ║

║ **Quote** Currency:     US Dollar (USD)                    ║

║ Exchange Rate:    1 EUR = 1.08 USD (2/11/2024)║

║                                                                                 ║

║ Direct Quote: USD/EUR                              ║

║ -------------------------------­­------------------------------║

║**Base** Currency:        US Dollar (USD)                    ║

║**Quote** Currency:       Euro (EUR)                           ║

║ Exchange Rate:     1 USD = 0.93 EUR (2/11/2024)║

║                                                                                  ║

║ **Quote** Currency:       US Dollar (USD)                   ║

║ Exchange Rate:     1 EUR = 1.08 USD (2/11/2024)║

║                                                                                  ║

║ Direct Quote= 1/ Indirect Quote                ║

║                                                                                  ║

╚═════════════════════════════╝

In Class Exercise

1. What is the quote currency in the EUR/USD currency pair?

a) EUR

b) USD

c) GBP

**Answer: b**

**Explanation:** In the EUR/USD pair, the quote currency is the US Dollar (USD). It represents the amount of USD needed to purchase one unit of Euro (EUR).

2. In a direct quote, what is the quote currency?

a) Foreign currency

b) Domestic currency

c) Base currency

**Answer: a**

**Explanation:** In a direct quote, the quote currency is the foreign currency, while the base currency is the domestic currency. The quote currency is the currency being sold or bought.

3. Which currency pair represents an indirect quote?

a) USD/JPY

b) GBP/USD

c) USD/EUR

**Answer: b**

**Explanation:** In an indirect quote, the quote currency is the domestic currency. In the GBP/USD pair, the quote currency (USD) is the domestic currency, so it is an indirect quote.

4. What determines the value of one unit of the base currency in a currency pair?

a) The quote currency

b) The interest rate

c) The exchange rate

**Answer: a**

**Explanation**: The value of one unit of the base currency is determined by the quote currency. It shows how much of the quote currency is needed to buy one unit of the base currency.

5. Which currency pair is a direct quote?

a) EUR/GBP

b) USD/CHF

c) GBP/JPY

**Answer: c**

**Explanation**: In a direct quote, the base currency is the domestic currency and the quote currency is the foreign currency. In the USD/CHF pair, the US Dollar (USD) is the base currency, and the Swiss Franc (CHF) is the quote currency. Therefore, USD/CHF is a direct quote.

6. What currency pair represents the value of one Euro in US Dollars?

a) EUR/USD

b) USD/EUR

c) EUR/GBP

**Answer: a**

**Explanation:** In the EUR/USD pair, the value of one Euro is represented in US Dollars. It shows how many US Dollars are needed to buy one Euro.

7. Which currency pair represents the value of one British Pound in US Dollars?

a) GBP/USD

b) USD/GBP

c) GBP/EUR

**Answer: a**

**Explanation**: In the GBP/USD pair, the value of one British Pound is represented in US Dollars. It shows how many US Dollars are needed to buy one British Pound.

8. What currency is the base currency in the USD/CHF pair?

a) USD

b) CHF

c) EUR

**Answer: a**

**Explanation**: In the USD/CHF pair, the base currency is the