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https://www.100test.com/kao_ti2020/120/2021_2022__E5_BE_90_E7_BB_BD2006_c83_120794.htm Passage 3 Exchange Rates A Brief History of Exchange Rates For centuries， the currencies of the world were backed by gold. That is， a piece of paper currency issued by any world government represented a real amount of gold held in a vault by that government. In the 1930s， the U.S. set the value of the dollar at a single， unchanging level： 1 ounce of gold was worth $ 35. After World War II， other countries based the value of their currencies on the U.S. dollar. Since everyone knew how much gold a U.S. dollar was worth， then the value of any other currency against the dollar could be based on its value in gold. A currency worth twice as much gold as a U. S dollar was, therefore， also worth two U.S. dollars. Unfortunately， the real world of economics outpaced this system. The U. S. dollar suffered from in flation （its value relative to the goods it could purchase decreased）， while other currencies became more valuable and more stable. Finally， in 1971， the U.S. took away the gold standard altogether. This meant that the dollar no longer represented an actual amount of a precious substancemarket forces alone determined its value. Today， the U.S. dollar still dominates many financial markets. In fact， exchange rates are often expressed in terms of U. S. dollars. Currently， the U.S. dollar and the emro account for approximately 50 percent of ‘ all currency exchange transactions in the world. Adding British pounds， Canadian dollars

， Australian dollars， and Japanese yen to the list accounts for over 80 percent of currency exchanges altogether. Methods of Exchange ： the Floating Exchange Rate There are two main systems used to determine a currency ‘ s exchange rate ： floating currency and pegged currency. The market determines a floating exchange rate. In other words， a currency is worth whatever buyers are willing to pay for it. This is determined by supply and demand， which is in turn driven by foreign investment， import/export ratios， inflation， and a host of other economic factors. Generally， countries with mature， stable economic markets will use a floating system. Virtually every major nation uses this system， including the U. S. ， Canada and Great Britain. Floating exchange rates are considered more efficient， because the market will automatically correct the rate to reflect inflation and other economic forces. The floating system isn ‘ t perfect， though. If a country ’ s economy suffers from instability， a floating system will discourage investment. Investors could fall victim to wild swings in the exchange rates， as well as disastrous inflation. Methods of Exchange ： the Pegged Exchange Rate A pegged， or fixed system， is one in which the exchange rate is set and artificially maintained by the government. The rate will be pegged to some other country ‘ s dollar， usually the U.S. dollar. The rate will not fluctuate from day to day. A government has to work to keep their pegged rate stable. Their national bank must hold large reserves of foreign currency to mitigate changes in supply and demand. If a sudden demand for a currency were to drive up the exchange rate， the national bank would have to release enough of that currency into the market to meet the demand， They can also buy up currency if low demand is lowering exchange rates. Countries that have immature， potentially unstable economies usually use a pegged system. Developing nations can use this system to prevent out-of-control inflation. The system can backfire， however， if the real world market value of the currency is not reflected by the pegged rate. In that case， a black market may spring up， where the currency will be traded at its market value， disregarding the government‘s peg. When people realize that their currency isn‘t worth as much as the pegged rate indicates， they may rush to exchange their money for other， more stable currencies. This can lead to economic disaster， since the sudden flood of currency in world markets drives the exchange rate very low. So if a country doesn’t take good care of their pegged rate， they may find themselves with worthless currency. 