CHAPTER 38 Exchange Rates, the Balance of Payments, and Trade Deficits

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Multiple Choice Questions

Financing international trade

- 1. U.S. export transactions create:
 - A) a U.S. demand for foreign monies and the satisfaction of this demand decreases the supplies of dollars held by foreign banks.
 - B) a U.S. demand for foreign monies and the satisfaction of this demand increases the supplies of dollars held by foreign banks.
 - C) a foreign demand for dollars and the satisfaction of this demand decreases the supplies of foreign monies held by U.S. banks.
 - D) a foreign demand for dollars and the satisfaction of this demand increases the supplies of foreign monies held by U.S. banks.
- 2. U.S. import transactions create:
 - A) a foreign demand for dollars and the satisfaction of this demand decreases the supplies of foreign monies held by U.S. banks.
 - B) a foreign demand for dollars and the satisfaction of this demand increases the supplies of foreign monies held by U.S. banks.
 - C) a U.S. demand for foreign monies and the satisfaction of this demand decreases the supplies of foreign monies held by U.S. banks.
 - D) a U.S. demand for foreign monies and the satisfaction of this demand increases the supplies of dollars held by foreign banks.
- 3. If a U.S. importer can purchase 10,000 pounds for \$20,000, the rate of exchange is:
 - A) \$1 = 2 pounds in the United States.
 - B) \$2 = 1 pound in the United States.
 - C) \$1 = 2 pounds in Great Britain.
 - D) \$.5 = 1 pound in Great Britain.
- 4. Which of the following creates a supply of Canadian dollars in foreign exchange markets?
 - A) a Frenchman redeems a bond issued by a Canadian manufacturer
 - B) a Canadian exporter buys insurance from a U.S. firm

- C) an American student takes a summer trip to Canada
- D) a U.S. importer buys 500 cases of Canadian maple syrup
- 5. Other things equal, the financing of a U.S. export transaction:
 - A) reduces U.S. interest rates.
 - B) decreases the supplies of foreign currency held by United States banks.
 - C) decreases GDP in the United States.
 - D) increases the supplies of foreign currency held by U.S. banks.
- 6. Other things equal, the financing of a U.S. import transaction:
 - A) increases the supplies of foreign currency held by United States banks.
 - B) increases U.S. interest rates.
 - C) decreases the supplies of foreign currency held by U.S. banks.
 - D) increases GDP in the United States.

Balance of payments

- 7. Which of the following would call for inpayments to the United States?
 - A) gold flows into the United States
 - B) U.S. firms sell insurance to Brazilian shippers
 - C) U.S. sends foreign aid to developing countries
 - D) U.S. imports German automobiles
- 8. Which of the following would call for outpayments from the United States?
 - A) U.S. exports computer software
 - B) U.S. purchases assets abroad
 - C) foreigners purchase assets in the United States
 - D) foreign tourists spend money in the United States.
- 9. The current account in a nation's balance of payments includes:
 - A) its goods exports and imports, and its services exports and imports.
 - B) changes in its official reserves.
 - C) purchases of foreign assets, and foreign purchases of assets.
 - D) all of the above.
- 10. A nation's capital account:
 - A) contains inpayment items, but not outpayment items.
 - B) includes service exports and service imports.
 - C) includes both inpayments and outpayments.
 - D) includes net investment income and net transfers.
- 11. In 1999, the capital account in the U.S. balance of payments was in:
 - A) deficit, and larger than the current account surplus.
 - B) surplus, and larger than the current account surplus.
 - C) balance, with no deficit or surplus.
 - D) surplus, and smaller than the current account deficit.

- 12. The capital aaccount balance is a nation's:
 - A) net investment income minus its net transfers.
 - B) exports of goods and services minus its imports of goods and services.
 - C) sale of real and financial assets to people living abroad minus its purchases of real and financial assets from foreigners.
 - D) domestic investment spending minus domestic saving.
- 13. A nation's official reserves account:
 - A) compensates for differences in the current and capital accounts.
 - B) is always positive.
 - C) is always zero.
 - D) is always negative.
- 14. If a nation has a current account surplus and its official reserves account balance is zero, it must have a:
 - A) surplus in its capital account.
 - B) balance of payments deficit.
 - C) balance of payments surplus.
 - D) deficit in its capital account
- 15. If a nation has a current account deficit and its official reserves account balance is zero, it must have a:
 - A) surplus in its capital account.
 - B) balance of payments deficit.
 - C) balance of payments urplus.
 - D) deficit in its capital account.
- 16. In the U.S. balance of payments, foreign purchases of assets in the United States are a:
 - A) foreign currency outflow.
 - B) foreign currency inflow.
 - C) current account item.
 - D) debit, or outpayment

17. In the U.S. balance of payments, U.S. purchases of assets abroad are a:

- A) U.S. dollar outflow.
- B) U.S. dollar inflow.
- C) current account item.
- D) debit, or outpayment
- 18. Which of the following combinations is plausible, as it relates to a nation's balance of payments?
 - A) current account = +40 billion; capital account = +20 billion; official reserves account = -50 billion.
 - B) current account +50 billion; capital account = -20 billion; official reserves account = +30 billion.
 - C) current account = +10 billion; capital account = +40 billion; official reserves account = +50 billion.
 - D) current account = \$ + 30 billion; capital account = \$ 20 billion; official reserves account = \$ 10 billion.
- 19. Which of the following combinations is plausible, as it relates to anation's balance of payments?
 - A) current account = +40 billion; capital account = +20 billion; official reserves account = -50 billion.
 - B) current account = -50 billion; capital account = +20 billion; official reserves account = +30 billion.
 - C) current account = +10 billion; capital account = +40 billion; official reserves account = +50 billion.
 - D) current account = \$ + 30 billion; capital account = \$ 20 billion; official reserves account = \$ billion.

- 20. There must always be a balance of a nation's:
 - A) goods exports and gold imports.
 - B) total international payments.
 - C) imports and exports of goods and services.
 - D) net transfers and net investment income.
- 21. Which of the following would contribute to a United States balance of payments surplus?
 - A) the United States makes a unilateral tariff reduction on imported goods
 - B) General Motors pays a dividend to a Swiss stockholder
 - C) the United States cuts back on U.S. military personnel stationed in Germany
 - D) Russian vodka becomes increasingly popular in the United States
- 22. Which of the following would contribute to a United States balance of payments deficit?
 - A) Kawasaki builds a motorcycle manufacturing plant in Kansas City
 - B) United States tourists travel in large numbers to Europe
 - C) a wealthy Mexican citizen builds a mansion in Beverly Hills
 - D) Zaire pays interest on its debt to the United States
- 23. Evidence of a chronic balance of payments deficit is:
 - A) a decline in amount of the nation's currency held by other nations.
 - B) an excess of exports over imports.
 - C) diminishing reserves of foreign currencies.
 - D) an increase in the international value of the nation's currency.

Use the following to answer questions 24-31:

The following table contains hypothetical data for the 2001 U.S. balance of payments. Answer the next question(s) on the basis of this information. All figures are in billions of dollars.

1)	U.S. goods exports	+\$100
2)	U.S. goods imports	-80
3)	U.S. service exports	+40
4)	U.S. service imports	-90
5)	Net investment income	+20
6)	Net transfers	-15
7)	Foreign purchases of assets in the United States	+30
8)	U.S. purchases of foreign assets abroad	-10
9)	Official reserves	+5

- 24. Refer to the above data. The United States has a balance of goods:
 - A) deficit of \$10 billion.
 - B) surplus of \$30 billion.
 - C) deficit of \$30 billion.
 - D) surplus of \$20 billion.

25. Refer to the above data. The U.S. balance on goods and services is a:

- A) \$10 billion deficit.
- B) \$20 billion deficit.
- C) \$30 billion surplus.
- D) \$30 billion deficit.

- 26. Refer to the above data. The U.S. balance on current account is a:
 - A) \$40 billion surplus.
 - B) \$25 billion deficit.
 - C) \$25 billion surplus.
 - D) \$30 billion deficit.
- 27. Item (6) above indicates that:
 - A) the United States used \$15 billion of its international monetary reserves to balance its international payments.
 - B) the United States provided \$15 billion of foreign aid to developing nations.
 - C) Americans provided a net amount of \$15 billion in remittances to the rest of the world.
 - D) Americans received a net amount of \$15 billion in remittances from the rest of the world.
- 28. Item (5) above indicates:
 - A) that the United States' current account was in surplus.
 - B) the size of the net inflow of foreign investment to the United States that occurred in 2001.
 - C) the net amount Americans received as interest and dividends on existing U.S. investments abroad.
 - D) the net amount Americans paid as interest and dividends on existing foreign investments in the United States.
- 29. Refer to the above data. The United States' balance on capital account is a:
 - A) \$20 billion surplus.
 - B) \$15 billion surplus.
 - C) \$30 billion deficit.
 - D) \$20 billion deficit.

30. Refer to the above data. The United States has a balance of payments:

- A) surplus of \$15.
- B) deficit of \$10.
- C) surplus of \$5.
- D) deficit of \$5.
- 31. Item (9) above indicates that:
 - A) exchange rates are freely floating.
 - B) the United States is adding to its stock of foreign currencies.
 - C) the United States is drawing down its stock of foreign currencies.
 - D) the United States has a balance of payments surplus.
- 32. If a nation's balance on current account is a *negative* \$200 billion, while its balance on capital account is a *positive* \$175 billion, we can conclude with certainty that this nation has a:
 - A) goods trade deficit.
 - B) goods trade surplus.
 - C) reduction in its stock of foreign currency.
 - D) balance of payments surplus.
- 33. If a nation's goods exports are \$55 billion, while its goods imports are \$50 billion, we can conclude with certainty that this nation has a:
 - A) balance of trade (goods) surplus.
 - B) balance of payments surplus.

- C) positive balance on current account.
- D) positive balance on goods and services.
- 34. It may be misleading to label a trade deficit as unfavorable or adverse because:
 - A) the multiplier does not apply to a trade deficit.
 - B) a trade deficit increases a nation's aggregate output and employment.
 - C) a nation's consumers benefit from a trade deficit during the period it occurs.
 - D) a trade deficit precludes inflation.
- 35. Which of the following is *not* included in the current account of a nation's balance of payments?
 - A) its goods exports
 - B) its goods imports
 - C) its net investment income
 - D) its purchases of real assets abroad
- 36. A deficit on the current account:
 - A) normally causes a surplus on the capital account.
 - B) normally causes a deficit on the capital account.
 - C) has no relationship to the capital account.
 - D) means that a nation is making international transfers.

Use the following to answer questions 37-41:

Answer the next question(s) on the basis of the following 2001 balance of payments data (+ and -) for the hypothetical nation of Zabella. All figures are in billions of dollars.

Current Account

1) Goods exports	+\$80	
2) Goods imports	-70	
3) Exports of services	+20	
4) Imports of services	-25	
5) Net investment income	+5	
6) Net transfers	-5	
Capital Account		
7) Foreign purchases of assets in the United States	+13	
8) U.S. purchases of assets abroad	-23	
Official Reserves Account		
9) Official reserves	+5	

- 37. Refer to the above data. Zabella has a balance of trade (goods):
 - A) deficit of \$10 billion.
 - B) surplus of \$5 billion.
 - C) surplus of \$10 billion.
 - D) deficit of \$5 billion.

38. Refer to the above data. Zabella's balance on goods and services shows a:

- A) \$5 billion deficit.
- B) \$5 billion surplus.
- C) \$10 billion surplus.
- D) \$15 billion deficit.

- 39. Refer to the above data. Zabella's balance on capital account shows a:
 - A) deficit of \$10 billion.
 - B) surplus of \$5 billion.
 - C) deficit of \$28 billion.
 - D) surplus of \$13 billion.

40. Refer to the above data. Zabella has a balance of payments:

- A) deficit of \$5 billion.
- B) surplus of \$10 billion.
- C) deficit of \$10 billion.
- D) surplus of \$5 billion.
- 41. Refer to the above data. The official reserves account indicates that Zabella:
 - A) added \$5 billion to its stock of foreign currencies.
 - B) imported more goods and services than it exported.
 - C) "exported" \$5 billion of its stock of foreign currencies.
 - D) experienced a balance of payments surplus in 2001.

Use the following to answer questions 42-48:

The plus items below are "export-type" entries and the minus items are "import-type" entries in the balance of payments for the hypothetical country of Zippo. Use the following list to answer the next question(s):

1)	Goods exports	+\$200
2)	Official reserves	0
3)	Net transfers	0
4)	Imports of services	-100
5)	Net investment income	0
6)	U.S. purchases of assets abroad	-50
7)	Goods imports	-250
8)	Foreign purchases of assets in the United States	+150
9)	Export of services	+50

- 42. Refer to the above information. The current account items for Zippo are:
 - A) 1, 2, 3, and 4.
 - B) 1, 3, 4, 5, 7, and 9.
 - C) 6 and 8.
 - D) 1, 2, 4, 7, and 9.

43. Refer to the above information. The capital account items for Zippo are:

- A) 1, 2, 3, and 4.
- B) 1, 3, 4, 5, 7, and 9.
- C) 6 and 8.
- D) 1, 2, 4, 7, and 9.
- 44. Refer to the above information. Zippo has a: A) current account surplus.

- B) capital account deficit.
- C) capital account surplus.
- D) surplus on goods and services.
- 45. Refer to the above information. Zippo has a:
 - A) current account deficit.
 - B) capital account deficit.
 - C) balance of payments deficit.
 - D) trade surplus on goods and services.
- 46. Refer to the above information. Zippo has:
 - A) a current account surplus.
 - B) a capital account deficit.
 - C) a trade surplus on goods and services.
 - D) neither a balance of payments deficit nor a surplus.
- 47. Refer to the above information. Zippo has a:
 - A) current account surplus.
 - B) capital account deficit.
 - C) trade deficit on goods and services.
 - D) balance of services surplus.
- 48. Refer to the above information. On the basis of its balance of payments position, and other things equal, we can expect the international value of Zippo's currency to:
 - A) increase.
 - B) decrease.
 - C) remain constant.
 - D) gyrate up and down.
- 49. In the balance of payments of the United States, a reduction of U.S. holdings of official reserves of foreign currencies is recorded as a:
 - A) current account entry.
 - B) negative entry.
 - C) net transfer.
 - D) positive entry.
- 50. In the balance of payments of the United States, U.S. goods imports are recorded as a:
 - A) positive entry.
 - B) capital account entry.
 - C) current account entry.
 - D) official reserves entry.
- 51. In the balance of payments of the United States, inflows of foreign currencies to the United States are recorded as:
 - A) a positive entry.
 - B) a current account entry.
 - C) official reserves.
 - D) net investment income.

- 52. Which one of the following will not directly affect the U.S. balance on current account?
 - A) an increase in U.S. goods imports
 - B) a decrease in U.S. net investment income
 - C) an increase in U.S. purchases of assets abroad
 - D) an increase in U.S. imports of services
- 53. Which one of the following, other things equal, will directly alter the United States balance of trade?
 - A) an increase in official reserves
 - B) a decrease in U.S. goods exports
 - C) an increase in net transfers
 - D) a decrease in U.S. purchases of assets abroad.
- 54. Which item below will affect the U.S. balance on goods and services, but not affect its balance of trade in goods?
 - A) an increase in U.S. goods exports
 - B) a decrease in U.S. exports of services
 - C) an increase in official reserves
 - D) an increase in net transfers
- 55. In a nation's balance of payments, which one of the following items is always recorded as a positive entry?
 - A) goods imports
 - B) changes in foreign currency reserves
 - C) U.S. purchases of assets abroad
 - D) exports of services

Exchange rates

- 56. A market in which the money of one nation is exchanged for the money of another nation is a:
 - A) resource market.
 - B) bond market.
 - C) stock market.
 - D) foreign exchange market.
- 57. If the dollar price of yen rises, then:
 - A) the yen price of dollars also rises.
 - B) the dollar depreciates relative to the yen.
 - C) the yen depreciates relative to the dollar.
 - D) the dollar will buy fewer U.S. goods.
- 58. If the exchange rate between the U.S. dollar and the Japanese yen is 1 = 200 yen, then the dollar price of yen is: A) 0.005.
 - B) \$.05.
 - C) \$.50.
 - D) \$5.
- 59. The following are hypothetical exchange rates: \$1 = 140 yen; 1 Swiss franc = \$.10. We can conclude that:
 - A) 1 yen = 280 Swiss francs.
 - B) 1 yen = 14 Swiss francs.
 - C) 1 Swiss franc = 28 yen.

- D) 1 Swiss franc = 14 yen.
- 60. The following are hypothetical exchange rates: 2 euros = 1 pound; 1 = 2 pounds. We can conclude that: A) \$1 = 4 euros.
 - B) \$1 = .5 euros.
 - C) 1 euros = \$.50.
 - D) 1 euro = \$2.
- 61. If the rate of exchange for a pound is \$4, the rate of exchange for the dollar is:
 - A) $1/_4$ pound.
 - B) 4 pounds.
 - C) \$.25.
 - D) \$1.00.
- 62. In considering yen and dollars, when the dollar rate of exchange for the yen rises:
 - A) the yen rate of exchange for the dollar will fall.
 - B) the yen rate of exchange for the dollar will also rise.
 - C) the yen rate of exchange for the dollar may either fall or rise.
 - D) U.S. net exports to Japan will fall.

63. In considering euros and dollars, the rates of exchange for the euro and the dollar:

- A) are directly related.
- B) are inversely related.
- C) are unrelated.
- D) move in the same direction.
- 64. If the equilibrium exchange rate changes so that fewer dollars are needed to buy a South Korean won, then:
 - A) Americans will buy fewer Korean goods and services.
 - B) the won has appreciated in value.
 - C) fewer U.S. goods and services will be demanded by the South Koreans.
 - D) the dollar has depreciated in value.
- 65. If the exchange rate changes so that more Mexican pesos are required to buy a dollar, then:
 - A) the peso has appreciated in value.
 - B) Americans will buy more Mexican goods and services.
 - C) more U.S. goods and services will be demanded by the Mexicans.
 - D) the dollar has depreciated in value.
- 66. Depreciation of the dollar will:
 - A) decrease the prices of both U.S. imports and exports.
 - B) increase the prices of both U.S. imports and exports.
 - C) decrease the prices of U.S. imports, but increase the prices to foreigners of U.S. exports.
 - D) increase the prices of U.S. imports, but decrease the prices to foreigners of U.S. exports.
- 67. Appreciation of the Canadian dollar will:
 - A) intensify an existing disequilibrium in Canada's balance of payments.
 - B) make Canada's exports less expensive and its imports more expensive.

- C) make Canada's exports more expensive and its imports less expensive.
- D) make Canada's exports and imports both more expensive.
- 68. If the dollar depreciates relative to the Russian ruble, the ruble:
 - A) will be less expensive to Americans.
 - B) may either appreciate or depreciate relative to the dollar.
 - C) will appreciate relative to the dollar.
 - D) will depreciate relative to the dollar.
- 69. The U.S. demand for British pounds is:
 - A) downsloping because a higher dollar price of pounds means British goods are cheaper to Americans.
 - B) downsloping because a lower dollar price of pounds means British goods are more expensive to Americans.
 - C) upsloping because a lower dollar price of pounds means British goods are cheaper to Americans.
 - D) downsloping because a lower dollar price of pounds means British goods are cheaper to Americans.

Floating exchange rates; fixed exchange rates

- 70. The U.S. supply of Japanese yen is:
 - A) downsloping because a lower dollar price of yen means U.S. goods are cheaper to the Japanese.
 - B) upsloping because a higher dollar price of yen means U.S. goods are cheaper to the Japanese.
 - C) upsloping because a lower dollar price of yen means U.S. goods are cheaper to the Japanese.
 - D) downsloping because a higher dollar price of yen means U.S. goods are cheaper to the Japanese.
- 71. The U.S. demand for euros is:
 - A) downsloping because, at lower dollar prices for euros, Americans will want to buy more European goods and services.
 - B) downsloping because, at higher dollar prices for euros, Americans will want to buy more European goods and services.
 - C) downsloping because the dollar price of euros and the euro price of dollars are directly related.
 - D) upsloping because a higher dollar price of euros makes European goods and services more attractive to Americans.
- 72. Which of the following will generate a demand for country X's currency in the foreign exchange market?
 - A) travel by citizens of country X in other countries
 - B) the desire of foreigners to buy stocks and bonds of firms in country X
 - C) the imports of country X
 - D) charitable contributions by country X's citizens to citizens of developing nations

Use the following to answer questions 73-78:

Use the following diagram of a flexible exchange market for foreign currency to answer the next question(s):



- 73. Refer to the above diagram. At the equilibrium exchange rate:
 - A) \$1 will buy 1.25 euros.
 - B) 1 euro will buy \$.80.
 - C) 1.25 euro will buy 1.
 - D) \$1 will buy 8 euros.

74. Refer to the above diagram. At the price \$.80 for 1 euro:

- A) the quantity of euros demanded equals the quantity supplied.
- B) the dollar-euro exchange rate is unstable.
- C) the dollar price of 1 euro equals the euro price of 1 dollar.
- D) there will be a surplus of euros in the foreign exchange market.

75. Refer to the above diagram. Other things equal, a rightward shift of the demand curve would:

- A) depreciate the dollar.
- B) appreciate the dollar.
- C) reduce the equilibrium quantity of euros.
- D) depreciate the euro.
- 76. Refer to the above diagram. Other things equal, a leftward shift of the demand curve would:
 - A) depreciate the dollar.
 - B) appreciate the euro.
 - C) reduce the equilibrium quantity of euros.
 - D) cause a surplus of euros.
- 77. Refer to the above diagram. Other things equal, a leftward shift of the supply curve would:
 - A) appreciate the euro.
 - B) cause a shortage of euros.
 - C) increase the equilibrium quantity of euros.
 - D) appreciate the dollar.
- 78. Refer to the above diagram. Other things equal, a rightward shift of the supply curve would:
 - A) appreciate the euro.
 - B) cause a surplus of euros.
 - C) decrease the equilibrium quantity of euros.

D) appreciate the dollar.

Use the following to answer questions 79-82:



- 79. Refer to the above diagram. The initial demand for and supply of pesos are shown by D_1 and S_1 . The exchange rate will be:
 - A) *M* dollars for one peso.
 - B) 1/B pesos for one dollar.
 - C) A dollars for one peso.
 - D) C dollars for one peso.
- 80. Refer to the above diagram. The initial demand for and supply of pesos are shown by D_1 and S_1 . Suppose the United States reduces its imports of Mexican goods, shifting its demand for pesos from D_1 to D_2 . If the United States was operating under a system of exchange controls, the U.S. government would:
 - A) find that, at the controlled exchange rate, pesos would be in surplus.
 - B) be faced with deteriorating terms of trade.
 - C) be faced with the problem of rationing BG pesos to U.S. importers who want BF pesos.
 - D) be faced with the problem of rationing BF pesos to U.S. importers who want BG pesos.
- 81. Refer to the above diagram. The initial demand for and supply of pesos are shown by D_1 and S_1 . If the decline in U.S. imports from Mexico described in the previous question occurred and the United States and Mexico were both on the international gold standard:
 - A) gold would flow from Mexico to the United States.
 - B) the exchange rate would rise from *B* dollars equals 1 peso to *C* dollars equals 1 peso.
 - C) gold would flow from the United States to Mexico.
 - D) the exchange rate would fall from B dollars equals 1 peso to A dollars equals 1 peso.
- 82. Refer to the above diagram. The initial demand for and supply of pesos are shown by D_1 and S_1 . If the decline in U.S. imports from Mexico described in the two previous questions occurred under a system of freely floating exchange rates:
 - A) gold would flow from Mexico to the United States.
 - B) the peso price of dollars would rise from 1/B pesos equals \$1 to 1/A pesos equals \$1.
 - C) a problem of rationing a shortage of pesos would arise in the United States.
 - D) the dollar price of pesos would increase to C dollars equals 1 peso.
- 83. Under a system of freely flexible (floating) exchange rates a U.S. trade deficit with Mexico will tend to cause:
 - A) the United States government to ration pesos to U.S. importers.
 - B) a flow of gold from the United States to Mexico.
 - C) an increase in the peso price of dollars.

- D) an increase in the dollar price of pesos.
- 84. Which of the following have substantially equivalent effects on a nation's volume of exports and imports?
 - A) exchange rate appreciation and a decrease in the domestic supply of money
 - B) exchange rate appreciation and domestic deflation
 - C) exchange rate depreciation and domestic deflation
 - D) exchange rate depreciation and domestic inflation
- 85. If in a system of fixed exchange rates the dollar price of euros is above the market equilibrium level:
 - A) gold will flow from the United States to Europe.
 - B) there will be a surplus of euros.
 - C) the United States government will have to ration euros to U.S. importers.
 - D) there will be a shortage of euros.

Use the following to answer questions 86-88:

Answer the next question(s) on the basis of the following table which indicates the dollar price of libras, the currency used in the hypothetical nation of Libra. Assume that a system of freely floating exchange rates is in place.

(1)	(2)	(3)	
Quantity of		Quantity of	
libras demanded	Dollar price	libras supplied	
(billions)	of libras	(billions)	
400	\$5	75	
300	4	100	
200	3	200	
100	2	325	

- 86. Refer to the above table. The equilibrium dollar price of libras is:
 - A) \$5.
 - B) \$4.
 - C) \$3.
 - D) \$2.

87. Refer to the above table. The exchange rate is:

- A) 4 libras for one dollar.
- B) .33 libras for one dollar.
- C) .40 libras for one dollar.
- D) 3 libras for one dollar.

88. Refer to the above table. Suppose that Libra decided to import more U.S. products. We would expect the quantity of libras:

- A) demanded at each dollar price to rise and the dollar to depreciate relative to the libra.
- B) demanded at each dollar price to fall and the dollar to appreciate relative to the libra.
- C) supplied at each dollar price to rise and the dollar to appreciate relative to the libra.
- D) supplied at each dollar price to fall and the dollar to depreciate relative to the libra.

Use the following to answer questions 89-90:

Answer the next question(s) on the basis of the following information: In 1985 the exchange rate between the U.S. dollar and the Japanese yen was \$1 = 262 yen; in 2001, the rate was \$1 = 125 yen.

- 89. Refer to the above information. Between 1985 and 2001 the:
 - A) dollar appreciated in value relative to the yen.
 - B) yen appreciated in value relative to the dollar.
 - C) dollar price of yen fell.
 - D) yen price of dollars rose.
- 90. Refer to the above information. Which one of the following might be a plausible explanation for the change in the dollar-yen exchange rate cited in the previous question?
 - A) Japan exported far more to the United States during this period than it imported from the United States.
 - B) Japan greatly increased its purchases of military equipment from the United States during this period.
 - C) Japan's economy grew far faster than the U.S. economy during this period.
 - D) Japan's government devalued the yen during this period.
- 91. Under a system of freely floating exchange rates, an increase in the international value of a nation's currency will:
 - A) cause an international surplus of its currency.
 - B) contribute to disequilibrium in its balance of payments.
 - C) cause gold to flow into that country.
 - D) cause its imports to rise.
- 92. According to the purchasing power parity theory of exchange rates:
 - A) a dollar, when converted to other currencies at the prevailing floating exchange rate, has the same purchasing power in various countries.
 - B) in equilibrium, national currencies have equal value in terms of gold.
 - C) the higher a nation's price level in terms of its own currency, the greater is the amount of foreign exchange it can obtain for a unit of its currency.
 - D) nominal currency values will tend to equalize (become 1 = 1) in the long run.
- 93. The idea that freely floating exchange rates equate the purchasing power of national currencies is called:
 - A) the equation of exchange.
 - B) the balance of payments.
 - C) Say's Law.
 - D) the purchasing power parity theory.
- 94. Assume that Japan and South Korea have floating exchange rates. Other things equal, if economic growth is more rapid in Japan than in South Korea:
 - A) gold bullion will flow out of Japan.
 - B) the Japanese yen will depreciate.
 - C) the South Korean won will depreciate.
 - D) the Japanese yen will appreciate.
- 95. Assume that Brazil and Mexico have floating exchange rates. Other things unchanged, if the price level is stable in Mexico but Brazil experiences rapid inflation:
 - A) gold bullion will flow into Braxil.
 - B) the Brazilian real will depreciate.
 - C) the Mexican peso will depreciate.
 - D) the Brazilian real will appreciate.

- 96. Assume that Switzerland and Britain have floating exchange rates. Other things unchanged, if a tight money policy raises interest rates in Britain as compared to Switzerland:
 - A) gold bullion will flow into Switzerland.
 - B) the Swiss franc will depreciate.
 - C) the pound will depreciate.
 - D) the Swiss franc will appreciate.

Use the following to answer questions 97-100:



- 97. Refer to the above diagram where D and S are the United States' demand for and supply of Swiss francs. At the equilibrium exchange rate, E, the United States' balance of payments is in equilibrium. A shift of the demand curve to D' might be the result of:
 - A) a relative decline in interest rates in Switzerland.
 - B) a reduction in the United States' relative price level.
 - C) a recession in the United States which slows its rate of growth.
 - D) a relative decline in interest rates in the United States.
- 98. Refer to the above diagram where D and S are the United States' demand for and supply of Swiss francs. At the equilibrium exchange rate, E, the United States' balance of payments is in equilibrium. Given a change in demand from D to D' the United States could maintain the dollar price of Swiss francs by:
 - A) shifting the S curve to the right through the use of domestic expansionary policies.
 - B) instituting exchange controls to ration Ed Swiss francs to U.S. importers who want Ec francs.
 - C) using international monetary reserves to cover the *Ec* shortage of Swiss francs.
 - D) using international monetary reserves to cover the *cd* shortage of Swiss francs.
- 99. Refer to the above diagram where D and S are the United States' demand for and supply of Swiss francs. At the equilibrium exchange rate, E, the United States' balance of payments is in equilibrium. Under a system of flexible exchange rates, the shift in demand from D to D' will:
 - A) ultimately reduce U.S. exports and raise U.S. imports.
 - B) cause the dollar to appreciate.
 - C) cause the Swiss franc to depreciate.
 - D) cause the dollar to depreciate.
- 100. Refer to the above diagram where D and S are the United States' demand for and supply of Swiss francs. At the equilibrium exchange rate, E, the United States' balance of payments is in equilibrium. Under a system of fixed exchange rates, the shift in demand from D to D' will cause:
 - A) the United States to increase its stocks of international monetary reserves.
 - B) a Swiss balance of payments deficit.

- C) a U.S. balance of payments deficit.
- D) a U.S. balance of payments surplus.
- 101. Under a system of fixed exchange rates, a nation that has chronic balance of payments deficits may:
 - A) initiate protectionist trade policies.
 - B) run short of international monetary reserves.
 - C) be forced to invoke contractionary monetary and fiscal policies.
 - D) do all of the above.
- 102. If the United States has full employment and the dollar dramatically depreciates in value, we can expect (other things equal):A) both U.S. imports and U.S. exports to rise.
 - B) both U.S. imports and U.S. exports to fall.
 - C) U.S. exports to fall and U.S. imports to increase.
 - D) inflation to occur.
- 103. Suppose interest rates fall sharply in the United States but are unchanged in Great Britain. Other things equal, under a system of freely floating exchange rates we can expect the demand for pounds in the United States to:
 - A) decrease, the supply of pounds to increase, and the dollar to appreciate relative to the pound.
 - B) increase, the supply of pounds to increase, and the dollar may either appreciate or depreciate relative to the pound.
 - C) increase, the supply of pounds to decrease, and the dollar to depreciate relative to the pound.
 - D) decrease, the supply of pounds to increase, and the dollar to depreciate relative to the pound.
- 104. Assume that, under a system of floating exchange rates, Mexicans decide to increase their investments in the United States. As a result:
 - A) the peso and the dollar will both depreciate.
 - B) the peso and the dollar will both appreciate.
 - C) the peso will depreciate and the dollar will appreciate.
 - D) the peso will appreciate and the dollar will depreciate.

Gold standard

- 105. Under the gold standard:
 - A) nations can protect their domestic price and employment levels from changes in the volume and direction of world trade.
 - B) exchange rates are virtually fixed.
 - C) differences in exports and imports will be precisely balanced by capital account flows, excluding gold.
 - D) exchange rates fluctuate freely in response to changes in the supply of, and demand for, foreign currencies.
- 106. Which of the following is *not* a condition of the international gold standard?
 - A) a nation must be willing to accept very wide fluctuations in its exchange rate
 - B) a nation must allow gold to be freely exported and imported
 - C) a nation must be willing to convert gold into paper money and vice versa at a stipulated rate
 - D) a nation must define its monetary unit in terms of a certain quantity of gold
- 107. Under the international gold standard:
 - A) a nation's exchange rate is virtually fixed.
 - B) domestic output and the price level will fall in those nations receiving international gold flows.
 - C) a nation's balance of payments surplus will be corrected by an outflow of gold.
 - D) a nation's balance of payments deficit will be corrected by an inflow of gold.

- 108. Under the international gold standard:
 - A) a nation sacrifices an independent monetary policy.
 - B) gold flows between nations would always promote macroeconomic stability.
 - C) exchange rates would fluctuate with changes in demand and supply.
 - D) balance of payments imbalances would be magnified.
- 109. Under the international gold standard:
 - A) exchange rates would fluctuate inversely with the domestic interest rates of the participating countries.
 - B) each nation must agree to depreciate its currency in direct proportion to the growth of its real GDP.
 - C) gold would flow into a nation experiencing a balance of payments surplus.
 - D) exchange rates would fluctuate directly with the domestic price levels of the various trading countries.
- 110. Under the gold standard a balance of payments disequilibrium would be corrected automatically by:
 - A) the depreciation of that country's currency.
 - B) an increase in the gold content of that nation's monetary unit.
 - C) the appreciation of that country's currency.
 - D) an outflow or inflow of gold.
- 111. Under the international gold standard a flow of gold from country A into country B would be halted by:
 - A) a rise in the price of B's currency measured in terms of A's currency.
 - B) government export controls on gold.
 - C) rising prices and incomes in B and falling prices and incomes in A.
 - D) rising prices and incomes in A and falling prices and incomes in B.

Bretton Woods system

- 112. The basis for the Bretton Woods international monetary system was:
 - A) a completely fixed system of exchange rates.
 - B) an adjustable peg system of exchange rates.
 - C) the gold standard.
 - D) a freely flexible system of exchange rates.
- 113. The Bretton Woods system of exchange rates relied on:
 - A) freely floating exchange rates.
 - B) fixed exchange rates with no mechanism for changing them.
 - C) fixed or pegged exchange rates, with occasional orderly adjustments to the rates.
 - D) the United States to set and periodically review worldwide exchange rates.
- 114. The Bretton Woods system of exchange rates:
 - A) is also known as the gold standard and met its demise in the 1930s.
 - B) relied heavily on floating exchange rates determined in the market for foreign exchange.
 - C) was abandoned in the 1930s.
 - D) was a system of fixed or pegged exchange rates, which occasionally could be adjusted.

Managed float

- 115. In saying that the present system of floating exchange rates is *managed* we mean that:
 - A) countries that allow their exchange rate to move freely will lose their borrowing privileges with the IMF.
 - B) the value of any IMF member's currency can only vary 2 percent from its par value.
 - C) IMF officials determine exchange rates on a day-to-day basis.
 - D) the central banks of various countries sometimes buy and sell foreign exchange to alter undesirable trends in exchange rates.
- 116. The exchange rate system currently used by the industrially advanced nations is:
 - A) the gold standard.
 - B) the Bretton Woods system.
 - C) the managed float.
 - D) a fixed rate system.
- 117. Under the managed floating system of exchange rates:
 - A) all exchange rates vary with changes in the free-market prices of gold.
 - B) industrialized nations meet once each year to negotiate readjustments in their exchange rates.
 - C) exchange rates are essentially flexible, but governments intervene to offset disorderly fluctuations in rates.
 - D) exchange rates are adjusted at the discretion of the IMF.
- 118. A government may be able to reduce the international value of its currency by:
 - A) selling its currency in the foreign exchange market.
 - B) buying its currency in the foreign exchange market.
 - C) selling foreign currencies in the foreign exchange market.
 - D) increasing its domestic interest rates.
- 119. The current system of exchange rates can best be described as:
 - A) freely fluctuating exchange rates.
 - B) managed floating exchange rates.
 - C) rigidly fixed exchange rates.
 - D) a crawling peg system.
- 120. Which of the following lists of exchange rates is arranged in proper historical order?
 - A) Bretton Woods system, gold standard, managed float
 - B) gold standard, managed float, Bretton Woods system
 - C) managed float, Bretton Woods system, gold standard
 - D) gold standard, Bretton Woods system, managed float
- 121. Which one of the following is not one of the so-called G-7 nations?
 - A) Japan
 - B) Canada
 - C) United States
 - D) Mexico
- 122. The Group of Seven (G-7) nations which periodically have jointly intervened to influence the value of the dollar include:
 - A) Canada, U.S., France, Britain, Mexico, Germany, and Brazil.
 - B) Canada, U.S., France, Japan, Italy, Germany, and Great Britain.
 - C) Canada, U.S., Mexico, Brazil, Argentina, Uruguay, and Chile.
 - D) Italy, France, Britain, Germany, Netherlands, Norway, and Sweden.

U.S. trade deficits

- 123. In recent years, the United States has had large:
 - A) current account surpluses.
 - B) capital account deficits.
 - C) balance of trade deficits.
 - D) balance of payments surpluses.
- 124. In recent years, the United States has had large:
 - A) current account surpluses.
 - B) current account deficits.
 - C) balance of trade surpluses.
 - D) balance of payments surpluses.
- 125. Relatively rapid U.S. growth between 1996 and 2000 contributed to large U.S. trade deficits by:
 - A) increasing U.S. national income, which decreased U.S. exports.
 - B) reducing real interest rates in the United States.
 - C) increasing U.S. tax revenues and reducing the Federal budget deficit.
 - D) increasing U.S. national income, which increased U.S. imports.
- 126. Two of the implications of large U.S. trade deficits for the United States are:
 - A) decreased current consumption and decreased indebtedness to foreigners.
 - B) reduced budget deficits and decreased indebtedness to foreigners.
 - C) reduced current consumption and higher saving.
 - D) increased current consumption and increased indebtedness to foreigners.
- 127. Largely because of large current account deficits, the United States:
 - A) is the leading exporting nation in the world.
 - B) has the world's largest external debt.
 - C) has the world's highest saving rate.
 - D) is experiencing an increase in its net inflow of investment income.
- 128. One of the consequences of the U.S. trade deficit is that:
 - A) domestic inflation has resulted.
 - B) the accumulation of American dollars in foreign hands has enabled foreign firms to build factories in America.
 - C) the distribution of income in the United States has become less unequal.
 - D) the system of flexible exchange rates has been abandoned in favor of a new gold standard.

Last Word Questions

- 129. (Last Word) People who buy foreign currency for the sole goal of selling it at a profit are called:
 - A) numismatics.
 - B) currency hedgers.
 - C) currency manipulators.
 - D) currency speculators.

- 130. (Last Word) Currency speculators aid international trade by:
 - A) absorbing exchange rate risk that others do not want to bear.
 - B) increasing the volatility of exchange rates.
 - C) making the demand for imports less elastic.
 - D) promoting barter.
- 131. (Last Word) Firms engaged in international trade can reduce exchange-rate risk by:
 - A) paying for foreign goods only when they are delivered.
 - B) buying on credit.
 - C) hedging in the futures market.
 - D) dealing only with highly reputable firms.

True/False Questions

- 132. Under the international gold standard, exchange rates fluctuate without restraint to correct any international disequilibrium by affecting the relative attractiveness of domestic and foreign goods.
- 133. If the United States and France are both on the international gold standard and U.S. exports to France exceed United States imports from France, gold will flow from the United States to France.
- 134. U.S. exports increase and U.S. imports decrease the supplies of foreign monies owned by U.S. banks.
- 135. Under freely flexible (floating) exchange rates, if the dollar price of pounds rises, the pound price of dollars will fall.
- 136. If the price of British pounds, measured in terms of U.S. dollars, is rising, then the price of U.S. dollars, measured in terms of British pounds, is also rising.
- 137. Under freely flexible (floating) exchange rates a U.S. trade deficit with Japan will eventually cause the dollar price of yen to rise.
- 138. A nation that imports more goods and services than it exports is necessarily realizing an international balance of payments deficit.
- 139. If the dollar depreciates, U.S. exports will eventually rise and U.S. imports will eventually fall.
- 140. A system of fixed exchange rates is more likely to result in exchange controls than is a system of flexible (floating) exchange rates.

Use the following to answer questions 141-147:

Answer the next question(s) on the basis of the following 2001 balance of payments statement for Transylvania. All figures are in billions of dollars.

Goods exports	+\$15
Goods imports	-17
Service exports	+5
Service imports	-2
Net investment income	-5
Net transfers	+4
Foreign purchases of assets	+5
Purchases of foreign assets	-11
Official reserves	+1

- 141. Refer to the above data. In 2001 Transylvania imported more products than it exported.
- 142. Refer to the above data. Transylvania had a \$2 billion balance of trade (goods) surplus in 2001.
- 143. Refer to the above data. In 2001 Transylvania realized a \$1 billion surplus on goods and services.
- 144. Refer to the above data. In 2001 Transylvania was a net recipient of transfers from the rest of the world.
- 145. Refer to the above data. Foreigners made a smaller volume of asset purchases in Transylvania in 2001 than Transylvanians made asset purchases abroad.
- 146. Refer to the above data. Transylvania realized a balance of payments deficit in 2001.
- 147. Refer to the above data. If Transylvania was on a system of freely floating exchange rates, its balance of payments position would cause the international value of its currency to depreciate.
- 148. The United States has had significant trade and current account surpluses in recent years.
- 149. A current account deficit will reduce U.S. foreign indebtedness.