

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

- 1) Which of the following is NOT a major subaccount of the Balance of Payments? 1) _____
A) the accounts payable B) the financial account
C) the capital account D) the current account
- 2) Which of the following international transactions would NOT be counted as a balance of payments (BOP) transaction? 2) _____
A) An American tourist purchases cheese in Milwaukee, Wisconsin.
B) A Canadian lumber baron purchases a U.S. corporate bond through an investment broker in Seattle.
C) The U.S. subsidiary of a British firm pays profits (dividends) back to its parent firm in London.
D) All of the above are considered BOP transactions.
- 3) The *balance of payments* as applied to a course in international finance may be defined as: 3) _____
A) the amount still owed by an exporting firm after making an initial down payment.
B) the amount still owed by governments to the International Monetary Fund.
C) the amount of a country's merchandise trade deficit or surplus.
D) the measurement of all international economic transactions between the residents of a country and foreign residents.
- 4) Balance of payment (BOP) data may be important for any of the following reasons: 4) _____
A) Changes in a country's BOP may signal a change in controls over payment of dividends and interest.
B) The BOP is an important indicator of a country's foreign exchange rate.
C) BOP data helps to forecast a country's market potential, especially in the short run.
D) all of the choices provided above
- 5) A country experiencing a serious BOP _____ is more likely to _____ exports than otherwise. 5) _____
A) deficit; expand B) surplus; contract
C) surplus; expand D) none of the above
- 6) Which of the following would NOT be considered a typical BOP transaction? 6) _____
A) The U.S. subsidiary of European financial giant, Credit Suisse, pays dividends to its parent in Zurich.
B) A U.S. tourist purchases gifts at a museum in London.
C) Toyota U.S.A. is a U.S. distributor of automobiles manufactured in Japan by its parent company.
D) All are example of BOP transactions.

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

- 7) When the world went to a system of floating exchange rates, the Balance of Payments became a relic of a system of fixed exchange rates and is no longer watched by serious economic groups. 7) _____
- 8) Changes in the BOP may predict the imposition or removal of foreign exchange controls. 8) _____
- 9) A country experiencing a serious trade deficit is not as likely to expand imports as it would be if running a surplus. 9) _____

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

- 10) Which of the following is NOT a part of the *Current Account* of BOP? 10) _____
A) net export/import of services B) net export/import of goods
C) balance of trade D) net portfolio investment
- 11) Which of the following is NOT part of the *Financial Account* of the BOP? 11) _____
A) net portfolio investment B) net foreign direct investment
C) net import/export of services D) other Financial items
- 12) Which of the following is NOT an item to be considered in BOP calculations? 12) _____
A) A consumer buys a VCR made in Korea from a Florida Wal-Mart store.
B) A foreign resident purchases a U.S. Treasury Bill.
C) A U.S.-based firm manages the development of an oil field in Kazakhstan.
D) A U.S. citizen living in Minnesota travels to Winnipeg, Canada, and buys a case of LaBatt's Canadian beer.
- 13) The *balance of payments*: 13) _____
A) determines the eligibility of countries for IMF aid.
B) records all international transactions for a country over a period of time.
C) adds up the value of all assets and liabilities of a country on a specific date.
D) all of the above
- 14) An American tourist purchases a leather jacket while in Italy. Which of the following statements is true? 14) _____
A) This transaction would be properly accounted for in the *Current Account* of the U.S. BOP.
B) The leather purchase would be considered an import for the U.S. BOP.
C) The leather purchase is considered an import of a good, and thus, considered part of the balance of trade as well.
D) All of these statements are true.

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

- 15) The authors identify a tip for understanding BOP accounting. They recommend that you "follow the cash flow." 15) _____
- 16) The BOP must be in balance, but the current account need not be. 16) _____
- 17) Expenditures by U.S. tourists in foreign countries for foreign goods or services are factored into BOP calculations. 17) _____
- 18) Like a balance sheet, the Balance of Payments adds up the value of all assets and liabilities of a country on a specific date. 18) _____

SHORT ANSWER. Write the word or phrase that best completes each statement or answers the question.

- 19) What is a country's balance of (merchandise) trade, and why is it so widely reported in the financial and popular press? 19) _____
- 20) What is the Official Reserves Account (ORA), and why is it more important for countries under a fixed exchange rate regime than for ones under a floating exchange rate regime? 20) _____

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

- 21) Which of the following is NOT part of the *balance of payments* account? 21) _____
- A) the current account B) the official reserves account
C) the financial/capital account D) All of the above are BOP accounts.
- 22) The _____ includes all international economic transactions with income or payment flows occurring within the year. 22) _____
- A) current account B) IMF account
C) financial account D) capital account
- 23) If your company were to import and export textiles, the transactions would be recorded in the current account subcategory of: 23) _____
- A) services trade. B) income trade.
C) goods trade. D) current transfers.
- 24) The travel services provided to international travelers by United Airlines would be recorded in the current account subcategory of: 24) _____
- A) services trade. B) income trade.
C) goods trade. D) current transfers.

- 25) Anaconda Copper Inc. created a subsidiary in Chile last year to mine copper ore. The proportion of net income paid back to the parent company as a dividend would be recorded in the current account subcategory of: 25) _____
 A) services trade. B) income trade.
 C) goods trade. D) current transfers.
- 26) The subcategory that typically dominates the current account is: 26) _____
 A) transfer accounts. B) income trade.
 C) goods (merchandise) trade. D) services trade.
- 27) In 2010 the United States posted a current account deficit of -\$471 billion. The bulk of the negative value came from: 27) _____
 A) an income trade deficit. B) a goods trade deficit.
 C) a net transfer deficit. D) an income balance deficit.
- 28) Over the last two decades the surplus on U.S. services trade has typically been _____ the deficit on U.S. goods trade. 28) _____
 A) greater than
 B) less than
 C) equal to
 D) The relationship is constantly shifting from greater than to less than.

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

- 29) Because current and financial/capital account balances use double-entry bookkeeping it is unusual to find serious discrepancies in the debits and credits. 29) _____
- 30) In general, as a country's income increases, so does the demand for imports. 30) _____
- 31) For at least the last decade, the United States has consistently run a surplus in services trade income. 31) _____
- 32) Expenditures by U.S. students abroad and foreign students pursuing studies in the United States would be considered a services trade and part of the U.S. current account. 32) _____

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

- 33) The _____ of the balance of payments measures all international economic transactions of financial assets. 33) _____
 A) current account B) services account
 C) capital and financial accounts D) merchandise trade account

- 34) The financial account consists COMPLETELY of which four components? 34) _____
 A) direct investment, stock investment, net financial derivatives, and bond investment
 B) stock investment, bond investment, derivative investment, and mutual fund investment
 C) direct investment, portfolio investment, net financial derivatives, and other asset investment
 D) mutual fund investment, portfolio investment, derivative investment, and stock investment
- 35) When categorizing investments for the financial account component of the balance of payments the _____ is an investment where the investor has no control whereas the _____ is an investment where the investor has control over the asset. 35) _____
 A) direct investment; indirect investment
 B) portfolio investment; indirect investment
 C) portfolio investment; direct investment
 D) direct investment; portfolio investment
- 36) In general there is consensus that _____ should be free, but there is no such consensus that _____ should be free. 36) _____
 A) international investment; international trade
 B) international trade; international investment
 C) international trade; international goods trade
 D) international investment; international goods trade
- 37) The two major concerns about foreign direct investment are: 37) _____
 A) national defense and taxes.
 B) who receives the profits and taxes.
 C) who pays the taxes and who receives the taxes.
 D) who controls the assets and who receives the profits.
- 38) Portfolio investment is capital invested in activities that are _____ rather than made for _____. 38) _____
 A) control motivated; profit
 B) short term; the long term
 C) profit motivated; control
 D) long term; profit
- 39) Under an international regime of fixed exchange rates, countries with a BOP _____ should consider _____ their currency while countries with a BOP _____ should consider _____ their currency. 39) _____
 A) surplus, devaluing; deficit, revaluing
 B) surplus, revaluing; deficit, devaluing
 C) deficit, devaluing; surplus, devaluing
 D) deficit, revaluing; surplus, revaluing

- 40) Consider the following: A foreign automobile company builds a manufacturing plant in Tennessee and European investors buy U.S. Treasury Bonds. 40) _____
- A) Both activities would be considered portfolio investment.
 - B) Both activities would be considered direct investment.
 - C) The auto manufacturer is engaging in portfolio investment, and the European investors are engaged in direct investing.
 - D) The auto manufacturer is engaging in direct investment, and the European investors are engaged in portfolio investing.

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

- 41) International debt security purchases and sales are defined as portfolio investments for financial account purposes because by definition debt securities do not provide the buyer with ownership or control. 41) _____
- 42) Significant amounts of United States Treasury issues are purchased by foreign investors, therefore the U.S. must earn foreign currency to repay this debt. 42) _____
- 43) In the United States and most developed countries, the current account and the combined financial/capital accounts tend to be inversely related in that when one is positive, the other tends to be negative. 43) _____

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

- 44) China is currently experiencing a surplus in its current account and its capital/financial accounts. Which of the following is NOT a contributing factor for this unusual situation? 44) _____
- A) The positive prospects for China's continued growth contribute to the capital/financial account surplus.
 - B) China's inevitable acquisition of Taiwan is driving the market for Chinese investment.
 - C) The exceptional growth in the Chinese economy contributes to the current account surplus.
 - D) All of the above are contributing factors for China's twins surpluses.
- 45) If China wished to reduce their accumulation of foreign exchange reserves they could: 45) _____
- A) reduce their current account surplus by importing more goods than they export.
 - B) allow their currency, the yuan, to float freely in the market place.
 - C) undertake both of the activities identified in choices A and B.
 - D) dig a big hole and bury the reserves.

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

- 46) The biggest problem that China faces in maintaining a stable value for their currency, the yuan, is their lack of foreign exchange reserves. 46) _____
- 47) As of year-end 2010, the United States still held the world's largest foreign exchange reserve, but the total was rapidly being approached by China. 47) _____

48) China's current political plan includes reducing their foreign exchange reserve balance by allowing the yuan to float freely and by switching their goods balance from one of a net surplus to a net deficit. 48) _____

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

49) The largest single component of the United States current account is: 49) _____
A) services imports and exports.
B) income payments and receipts.
C) goods (merchandise) imports and exports.
D) current transfers.

50) Which of the following statements about the balance of payments is NOT true? 50) _____
A) Although the BOP must always balance in theory, in practice there are substantial imbalances as a result of statistical errors and misreporting of current account and financial account flows.
B) The BOP is the summary statement of all international transactions between one country and all other countries.
C) The BOP is a flow statement, summarizing all international transactions that occur across the geographic borders over a period of time, typically a year.
D) All of the above are true.

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

51) An excess of merchandise exports over merchandise imports results in a balance of trade deficit. 51) _____

52) The BOP should always balance. 52) _____

53) The transition to floating exchange rate regimes in the 1970s (described in Chapter 3) changed the focus from the total BOP to its various subaccount like the current and financial account balances. 53) _____

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

- 54) Use the following terms for this question: 54) _____
- C = consumption
 - I = capital investment spending
 - G = government spending
 - X = exports of goods and services
 - M = imports of goods and services
 - BOP = balance of payments
 - GDP = gross domestic product
 - NPV = net present value
 - INF = inflation
 - R = real rate of return

The static equation for the nations GDP is:

- A) $GDP = C + I + X - M + R$
 - B) $GDP = C + I + G + X + M$
 - C) $GDP = C + I + G + X - M$
 - D) $GDP = C + I + G + (X + M) \times INF$
- 55) Imports have the potential to lower a country's inflation rate because of each of the following EXCEPT: 55) _____
- A) the higher prices of foreign goods spurs domestic competitors to cut prices.
 - B) the import of lower priced services limits what domestic competitors can charge for services.
 - C) the import of lower priced goods limits what domestic competitors can charge for goods.
 - D) all of the above

- 56) Under a fixed exchange rate system, the government bears the responsibility to ensure that the BOP is near zero. If the sum of the current and capital accounts do not approximate zero, the government is expected to intervene in the foreign exchange market by buying or selling official foreign exchange reserves. If the sum of the first two accounts is GREATER THAN ZERO, a _____ demand for the domestic currency exists in the world. To preserve the fixed exchange rate, the government must then intervene in the foreign exchange market and _____ domestic currency for foreign currencies or gold so as to bring the BOP back near zero. 56) _____
- A) surplus; buy
 - B) deficit; sell
 - C) surplus; sell
 - D) deficit; buy

- 57) Under a fixed exchange rate system, the government bears the responsibility to ensure that the BOP is near zero. If the sum of the current and capital accounts do not approximate zero, the government is expected to intervene in the foreign exchange market by buying or selling official foreign exchange reserves. If the sum of the first two accounts is LESS THAN ZERO, a _____ demand for the domestic currency exists in the world. To preserve the fixed exchange rate, the government must then intervene in the foreign exchange market and _____ domestic currency for foreign currencies or gold so as to bring the BOP back near zero. 57) _____
- A) deficit; buy
 - B) deficit; sell
 - C) surplus; buy
 - D) surplus; sell

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

- 58) An increase in GDP should lead to a decrease in imports. 58) _____

- 59) The effect of an imbalance in the BOP is the same for countries on a fixed exchange rate regime as for those on a floating exchange rate regime. 59) _____
- 60) Under a floating exchange rate system, the government bears the responsibility to ensure that the BOP is near zero. 60) _____
- 61) A country with a managed float that wishes to WEAKEN its currency may choose to raise domestic interest rates to attract additional capital from abroad. 61) _____
- 62) A country's overall level of interest rates should have an impact on the financial account of the BOP. Relatively low real interest rates should normally stimulate an outflow of capital seeking higher interest rates in other country currencies. 62) _____
- 63) Imports have the potential to lower a country's inflation rate. In particular, imports of HIGHER-priced goods and services place a limit on what domestic competitors charge for comparable goods and services. 63) _____

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

- 64) Of the following, which is NOT a part of J-Curve adjustment path? 64) _____
 A) the exchange rate pass-through period
 B) the quantity adjustment period
 C) the currency contract period
 D) Each of the above is part of the J-Curve adjustment path.
- 65) Which of the following is NOT likely to occur in the quantity adjustment phase of the J-Curve adjustment path? 65) _____
 A) Exports become relatively less expensive.
 B) Imports become relatively more expensive.
 C) The balance of trade gets worse.
 D) All of the above are true.

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

- 66) When a currency is devalued the immediate impact may be an increase in a country's trade deficit. However, this situation tends to correct itself in 2 to 5 weeks. 66) _____

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

- 67) The authors identify four distinct periods of capital mobility since 1860. Which do they term as a "period of global economic destruction"? 67) _____
 A) 1860 - 1914 B) 1971 - 2007 C) 1914 - 1945 D) 1945 - 1971

- 68) _____ is the cross-border purchase of assets that are then managed in a way that hides the movement of money and its ownership. 68) _____
 A) Capital flight B) Capital mobility
 C) Money laundering D) Irrational exuberance
- 69) This was an era dominated by industrialized nation economies that were dependent on gold convertibility to maintain confidence in the system. 69) _____
 A) The Interwar Years , 1914-1945 B) The Gold Standard, 1860-1914
 C) The Bretton Woods Era, 1945-1971 D) The Floating Era, 1971-1997
- 70) This dollar-based fixed exchange rate system gave rise to a long period of economic recovery and growing openness of both international trade and capital flows in and out of more and more countries. 70) _____
 A) The Bretton Woods Era, 1945-1971 B) The Floating Era, 1971-1997
 C) The Interwar Years , 1914-1945 D) The Gold Standard, 1860-1914
- 71) An era of retrenchment, in which major economic powers returned to policies of isolationism and protectionism, restricting trade and nearly eliminating capital mobility. 71) _____
 A) The Interwar Years , 1914-1945 B) The Gold Standard, 1860-1914
 C) The Bretton Woods Era, 1945-1971 D) The Floating Era, 1971-1997
- 72) A _____ is any restriction that limits or alters the rate or direction of capital movement into or out of a country. 72) _____
 A) balance of trade deficit B) capital budget
 C) balance of trade surplus D) capital control

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

- 73) The Bretton Woods era realized a great expansion of international trade in goods and services. 73) _____

ESSAY. Write your answer in the space provided or on a separate sheet of paper.

- 74) Dutch Disease is a term applied to a problem in the 1970 whereby the Netherlands were experiencing massive and sudden inflows of capital from abroad. What was the cause of this sudden influx of capital, and what types of potential problems did it have for the Dutch or could it have for any small single resource country?

Answer Key

Testname: UNTITLED3

- 1) A
- 2) A
- 3) D
- 4) D
- 5) B
- 6) D
- 7) FALSE
- 8) TRUE
- 9) TRUE
- 10) D
- 11) C
- 12) A
- 13) B
- 14) D
- 15) FALSE
- 16) FALSE
- 17) FALSE
- 18) FALSE
- 19) The balance of trade (BOT) is the largest and most important subset of a country's current account. It measures the difference in a country's imports and exports over a specified time period. It is often reported because it is intuitively easy to understand (i.e., we either sell more or buy more from foreign countries) and it is a reasonable representation of the total current account balance. (For example, for the U.S. the BOT was -\$343B in 1999 while the current account balance was -\$331B.
- 20) The ORA is the total reserves held by official monetary authorities within the country. Under a fixed exchange regime a country's currency is convertible into a fixed amount of another country's currency. To keep the relationship between currencies at equilibrium, it may become necessary for the government to buy or sell official reserves until the equilibrium is restored. Under a variable rate regime this is not necessary as exchange rates are allowed to change and official reserves no longer serve the same purpose as under the fixed rate regime.
- 21) D
- 22) A
- 23) C
- 24) A
- 25) B
- 26) C
- 27) B
- 28) B
- 29) FALSE
- 30) FALSE
- 31) TRUE
- 32) TRUE
- 33) C
- 34) C
- 35) C
- 36) B

Answer Key

Testname: UNTITLED3

- 37) D
- 38) C
- 39) B
- 40) D
- 41) FALSE
- 42) FALSE
- 43) TRUE
- 44) B
- 45) C
- 46) FALSE
- 47) FALSE
- 48) FALSE
- 49) C
- 50) D
- 51) FALSE
- 52) FALSE
- 53) TRUE
- 54) C
- 55) A
- 56) C
- 57) A
- 58) FALSE
- 59) FALSE
- 60) FALSE
- 61) FALSE
- 62) TRUE
- 63) FALSE
- 64) D
- 65) C
- 66) FALSE
- 67) C
- 68) C
- 69) B
- 70) A
- 71) A
- 72) B
- 73) TRUE
- 74) With the rapid growth of the natural gas industry in the Netherlands in the 1970s, there was growing fear that massive capital inflows would drive up the demand for the Dutch guilder and cause a substantial currency appreciation. A more expensive guilder would then reduce the international competitiveness of other Dutch manufacturing industries, causing their relative decline to that of the natural resource industry. This is a challenge faced by a number of resource-rich economies of relatively modest size and relatively small export sectors.