

Chapter 2—International Flow of Funds

1. Recently, the U.S. experienced an annual balance of trade representing a ____.
- large surplus (exceeding \$100 billion)
 - small surplus
 - level of zero
 - deficit

ANS: D PTS: 1

2. A high home inflation rate relative to other countries would ____ the home country's current account balance, other things equal. A high growth in the home income level relative to other countries would ____ the home country's current account balance, other things equal.
- increase; increase
 - increase; decrease
 - decrease; decrease
 - decrease; increase

ANS: C PTS: 1

3. If a country's government imposes a tariff on imported goods, that country's current account balance will likely ____ (assuming no retaliation by other governments).
- decrease
 - increase
 - remain unaffected
 - either A or C are possible

ANS: B PTS: 1

4. ____ purchases more U.S. exports than the other countries listed here.
- Italy
 - Spain
 - Mexico
 - Canada

ANS: D PTS: 1

5. An increase in the current account deficit will place ____ pressure on the home currency value, other things equal.
- upward
 - downward
 - no
 - upward or downward (depending on the size of the deficit)

ANS: B PTS: 1

6. If the home currency begins to appreciate against other currencies, this should ____ the current account balance, other things equal (assume that substitutes are readily available in the countries, and that the prices charged by firms remain the same).
- increase
 - have no impact on

- c. reduce
- d. all of the above are equally possible

ANS: C PTS: 1

7. The International Financial Corporation was established to:
- a. enhance development solely in Asia through grants.
 - b. enhance economic development through non-subsidized loans (at market interest rates).
 - c. enhance economic development through low-interest rate loans (below-market rates).
 - d. enhance economic development of the private sector through investment in stock of corporations.

ANS: D PTS: 1

8. The World Bank was established to:
- a. enhance development solely in Asia through grants.
 - b. enhance economic development through non-subsidized loans (at market interest rates).
 - c. enhance economic development through low-interest rate loans (below-market rates).
 - d. enhance economic development of the private sector through investment in stock of corporations.

ANS: B PTS: 1

9. The International Development Association was established to:
- a. enhance development solely in Asia through grants.
 - b. enhance economic development through non-subsidized loans (at market interest rates).
 - c. enhance economic development through low-interest rate loans (below-market rates).
 - d. enhance economic development of the private sector through investment in stock of corporations.

ANS: C PTS: 1

10. Which of the following would likely have the least direct influence on a country's current account?
- a. inflation.
 - b. national income.
 - c. exchange rates.
 - d. tariffs.
 - e. a tax on income earned from foreign stocks.

ANS: E PTS: 1

11. The "J curve" effect describes:
- a. the continuous long-term inverse relationship between a country's current account balance and the country's growth in gross national product.
 - b. the short-run tendency for a country's balance of trade to deteriorate even while its currency is depreciating.
 - c. the tendency for exporters to initially reduce the price of goods when their own currency appreciates.
 - d. the reaction of a country's currency to initially depreciate after the country's inflation rate declines.

ANS: B PTS: 1

12. An increase in the use of quotas is expected to:
- a. reduce the country's current account balance, if other governments do not retaliate.
 - b. increase the country's current account balance, if other governments do not retaliate.
 - c. have no impact on the country's current account balance unless other governments retaliate.
 - d. increase the volume of a country's trade with other countries.

ANS: B PTS: 1

13. The U.S. typically has a balance of trade surplus in its trade with ____.
- a. China
 - b. Japan
 - c. A and B
 - d. none of the above

ANS: D PTS: 1

14. The North American Free Trade Agreement (NAFTA) increased restrictions on:
- a. trade between Canada and Mexico.
 - b. trade between Canada and the U.S.
 - c. direct foreign investment in Mexico by U.S. firms.
 - d. none of the above.

ANS: D PTS: 1

15. According to the text, international trade (exports plus imports combined) as a percentage of GDP is:
- a. higher in the U.S. than in European countries.
 - b. lower in the U.S. than in European countries.
 - c. higher in the U.S. than in about half the European countries, and lower in the U.S. than the others.
 - d. about the same in the U.S. as in European countries.

ANS: B PTS: 1

16. The direct foreign investment positions by U.S. firms have generally ____ over time. Restrictions by governments on direct foreign investment have generally ____ over time.
- a. increased; increased
 - b. increased; decreased
 - c. decreased; decreased
 - d. decreased; increased

ANS: B PTS: 1

17. Which of the following countries purchases the largest amount of exports by U.S. firms?
- a. Mexico
 - b. Japan
 - c. Canada
 - d. France

ANS: C PTS: 1

18. The primary component of the current account is the:
- balance of trade.
 - balance of money market flows.
 - balance of capital market flows.
 - unilateral transfers.
- ANS: A PTS: 1
19. As a result of the European Union, restrictions on exports between ____ were reduced or eliminated.
- member countries and the U.S.
 - member countries
 - member countries and European non-members
 - none of the above
- ANS: B PTS: 1
20. Over the last several years, international trade has generally:
- increased for most major countries.
 - decreased for most major countries.
 - stayed about constant for most major countries.
 - increased for about half the major countries and decreased for the others.
- ANS: A PTS: 1
21. Which is not a concern about the North American Free Trade Agreement (NAFTA)?
- its impact on U.S. inflation.
 - its impact on U.S. unemployment.
 - lower environmental standards in Mexico.
 - different health laws for workers in Mexico.
- ANS: A PTS: 1
22. A General Agreement on Tariffs and Trade (GATT) accord in 1993 called for:
- increased trade restrictions outside of North America.
 - lower trade restrictions around the world.
 - uniform environmental standards around the world.
 - uniform worker health laws.
- ANS: B PTS: 1
23. Which of the following is mentioned in the text as a possible means by which the government may attempt to improve its balance of trade position (increase its exports or reduce its imports).
- It could attempt to reduce its home currency's value.
 - The government could require firms to engage in outsourcing.
 - The government could require that its local firms pursue outsourcing.
 - All of the above are mentioned.
- ANS: A PTS: 1

24. The demand for U.S. exports tends to increase when:
- a. economic growth in foreign countries decreases.
 - b. the currencies of foreign countries strengthen against the dollar.
 - c. U.S. inflation rises.
 - d. none of the above.

ANS: B PTS: 1

25. "Dumping" is used in the text to represent the:
- a. exporting of goods that do not meet quality standards.
 - b. sales of junk bonds to foreign countries.
 - c. removal of foreign subsidiaries by the host government.
 - d. exporting of goods at prices below cost.

ANS: D PTS: 1

26. ____ is (are) income received by investors on foreign investments in financial assets (securities).
- a. Portfolio income
 - b. Direct foreign income
 - c. Unilateral transfers
 - d. Factor income

ANS: D PTS: 1

27. A weak home currency may not be a perfect solution to correct a balance of trade deficit because:
- a. it reduces the prices of imports paid by local companies.
 - b. it increases the prices of exports by local companies.
 - c. it prevents international trade transactions from being prearranged.
 - d. foreign companies may reduce the prices of their products to stay competitive.

ANS: D PTS: 1

28. Intracompany trade makes up approximately ____ percent of all international trade.
- a. 50
 - b. 70
 - c. 25
 - d. 13
 - e. 5

ANS: A PTS: 1

29. Like the International Monetary Fund (IMF), the ____ is composed of a collection of nations as members. However, unlike the IMF, it uses the private rather than the government sector to achieve its objectives.
- a. World Bank
 - b. International Financial Corporation (IFC)
 - c. World Trade Organization (WTO)
 - d. International Development Association (IDA)
 - e. Bank for International Settlements (BIS)

ANS: B PTS: 1

30. The World Bank's Multilateral Investment Guarantee Agency (MIGA):

- a. offers various forms of export insurance.
- b. offers various forms of import insurance.
- c. offers various forms of exchange rate risk insurance.
- d. provides loans to developing countries.
- e. offers various forms of political risk insurance.

ANS: E PTS: 1

31. Also known as the "central banks' central bank," the ____ attempts to facilitate cooperation among countries with regard to international transactions and provides assistance to countries experiencing a financial crisis.

- a. World Bank
- b. International Financial Corporation (IFC)
- c. World Trade Organization
- d. International Development Association (IDA)
- e. Bank for International Settlements (BIS)

ANS: E PTS: 1

32. Direct foreign investment into the U.S. represents a ____.

- a. capital inflow
- b. trade inflow
- c. capital outflow
- d. trade outflow

ANS: A PTS: 1

33. A balance of trade surplus indicates an excess of imports over exports.

- a. True
- b. False

ANS: F PTS: 1

34. A weakening of the U.S. dollar with respect to the British pound would likely reduce the U.S. exports to Britain and increase U.S. imports from Britain over time.

- a. True
- b. False

ANS: F PTS: 1

35. The World Bank extends loans only to developed nations, while the International Development Association (IDA) extends loans only to developing nations.

- a. True
- b. False

ANS: F PTS: 1

36. The World Bank frequently enters into cofinancing agreements. Under these agreements, financing is provided by the World Bank and/or official aid agencies, export credit agencies, or commercial banks.
- a. True
 - b. False

ANS: T PTS: 1

37. The balance of payments is a measurement of all transactions between domestic and foreign residents over a specified period of time.
- a. True
 - b. False

ANS: T PTS: 1

38. Changes in country ownership of long-term and short-term assets are measured in the balance of payments with the capital account.
- a. True
 - b. False

ANS: T PTS: 1

39. Portfolio investment represents transactions involving long-term financial assets (such as stocks and bonds) between countries that do not affect the transfer of control.
- a. True
 - b. False

ANS: T PTS: 1

40. The current account represents the investment in fixed assets in foreign countries that can be used to conduct business operations.
- a. True
 - b. False

ANS: F PTS: 1

41. Exporting of products by one country to other countries at prices below cost is called elasticity.
- a. True
 - b. False

ANS: F PTS: 1

42. Direct foreign investment by U.S.-based MNCs occurs primarily in the Bahamas and Brazil.
- a. True
 - b. False

ANS: F PTS: 1

43. The J curve effect is the initial worsening of the U.S. trade balance due to a weakening dollar because of established trade relationships that are not easily changed; as the dollar weakens, the dollar value of imports initially rises before the U.S. trade balance is improved.

a. True
b. False

ANS: T PTS: 1

44. Portfolio investments represent transactions involving long-term financial assets (such as stocks and bonds) between countries that do not affect the transfer of control.

a. True
b. False

ANS: T PTS: 1

45. Intracompany trade represents the exporting of products by one country to other countries below cost.

a. True
b. False

ANS: F PTS: 1

46. A tariff is a maximum limit on imports.

a. True
b. False

ANS: F PTS: 1

47. A country's net outflow of funds _____ affect its interest rates, and _____ affect its economic conditions.

a. does; does
b. does; does not
c. does not; does not
d. does not; does

ANS: A PTS: 1

48. The sale of patent rights by a U.S. firm to a Russian firm reflects a credit to the U.S. balance of payments account.

a. True
b. False

ANS: T PTS: 1

49. A U.S. purchase of patent rights from a firm in Mexico reflects a credit to the U.S. balance of payments account.

a. True
b. False

ANS: F PTS: 1

50. Regarding the U.S. balance of payments, capital account items are relatively minor compared to the financial account items.
- a. True
 - b. False

ANS: T PTS: 1

51. In recent years, the U.S. has had a relatively (compared to other countries) ____ balance of trade ____ with China.
- a. small; surplus
 - b. large; surplus
 - c. small; deficit
 - d. large; deficit

ANS: D PTS: 1

52. The Central American Trade Agreement (CAFTA) is intended to raise tariffs and regulations between the U.S., the Dominican Republic, and Central American countries.
- a. True
 - b. False

ANS: F PTS: 1

53. U.S. government officials would likely prefer that China devalue the yuan against the dollar.
- a. True
 - b. False

ANS: F PTS: 1

54. Assume that some U.S. firms will purchase supplies from either China or from U.S. firms. If the Chinese yuan appreciates against the dollar, it should reduce the U.S. balance of trade deficit with China.
- a. True
 - b. False

ANS: T PTS: 1

55. Assume the U.S. has a balance of trade surplus with the country of Thor. When individuals in Thor manufacture CDs and DVDs that look almost exactly like the original product produced in the U.S. and other countries, they ____ the U.S. balance of trade surplus with Thor. This activity is called ____.
- a. reduce; flipping
 - b. reduce; pirating
 - c. increase; pirating
 - d. increase; flipping

ANS: B PTS: 1

56. Japan's annual interest rate has been relatively ____ compared to other countries for several years, because the supply of funds in its credit market has been very ____.
- a. low; small

- b. high; small
- c. low; large
- d. high; large

ANS: C PTS: 1

57. Without the international capital flows, there would be ____ funding available in the U.S. across all risk levels, and the cost of funding would be ____ regardless of the firm's risk level.
- a. more; lower
 - b. more; higher
 - c. less; lower
 - d. less; higher

ANS: D PTS: 1

58. The primary component of the capital account is the balance of trade.
- a. True
 - b. False

ANS: F PTS: 1

59. A balance of trade surplus indicates an excess of merchandise imports over merchandise exports.
- a. True
 - b. False

ANS: F PTS: 1

60. An American tourist visiting Germany and spending money there (for lodging, food, etc.) will reduce the U.S. current account deficit and reduce Germany's current account balance.
- a. True
 - b. False

ANS: F PTS: 1

61. A balance of trade deficit indicates an excess of imports over exports.
- a. True
 - b. False

ANS: T PTS: 1

62. The capital account reflects changes in country ownership of long-term (but not short-term) assets.
- a. True
 - b. False

ANS: F PTS: 1

63. Outsourcing allows some MNCs to reduce costs but shifts jobs to other countries.
- a. True
 - b. False

ANS: T PTS: 1

64. A weakening of the U.S. dollar with respect to the British pound would likely reduce U.S. exports to the U.K. and increase U.S. imports from the U.K.
- a. True
 - b. False

ANS: F PTS: 1

65. The World Bank extends loans only to developed nations, while the International Development Association (IDA) extends loans only to developing nations.
- a. True
 - b. False

ANS: F PTS: 1

66. The ____ is the difference between exports and imports.
- a. balance of trade
 - b. balance on goods and services
 - c. balance of payments
 - d. current account
 - e. capital account

ANS: A PTS: 1

67. Which of the following will probably not result in an increase in a country's current account balance (assuming everything else constant)?
- a. A decrease in the country's rate of inflation
 - b. A decrease in the country's national income level
 - c. An increase in government restrictions in the form of tariffs or quotas
 - d. An appreciation of the country's currency
 - e. All of the above will result in an increased current account balance.

ANS: D PTS: 1

68. Which of the following factors probably does not directly affect a country's capital account and its components?
- a. Inflation
 - b. Interest rates
 - c. Withholding taxes on foreign income
 - d. Exchange rate movements
 - e. All of the above will directly affect a country's capital account.

ANS: A PTS: 1

69. The ____, an accord among 117 nations, called for lower tariffs around the world.
- a. General Agreement on Tariffs and Trade (GATT)
 - b. North American Free Trade Agreement (NAFTA)
 - c. Single European Act of 1987
 - d. European Union Accord
 - e. None of the above

ANS: A PTS: 1

70. Which of the following is not likely to represent a strategy by the government of Country X to reduce its balance of trade deficit with Country Y?
- a. The government of Country X eliminates environmental restrictions.
 - b. The government of Country X subsidizes firms in its country to facilitate dumping.
 - c. The government of Country X provides tax breaks to firms in specific industries.
 - d. The government of Country X removes a tariff on goods imported from Country Y.

ANS: D PTS: 1

71. Which of the following statements is not true?
- a. Exporters commonly complain that they are being mistreated because the currency of their country is too weak.
 - b. Outsourcing affects the balance of trade because it means that a service is purchased in another country.
 - c. Sometimes, trade policies are used to punish countries for various actions.
 - d. Tariffs imposed by the EU have caused some friction between EU countries that commonly import products and other EU countries.
 - e. All of the above are true.

ANS: A PTS: 1

72. Which of the following would increase the current account of Country X? Country Y is Country X's sole trading partner.
- a. Inflation increases in countries X and Y by comparable amounts.
 - b. Country X's and Country Y's currencies depreciate by the same amount.
 - c. Country X imposes tariffs on imports from Country Y, and Country Y retaliates by imposing an identical tax on X's exports.
 - d. The central banks of Country X and Country Y reduce the money supply to increase interest rates.
 - e. Country X imposes a quota on imports, and Country Y retaliates by imposing an identical quota on X's exports.

ANS: D PTS: 1

73. ____ represent aid, grants, and gifts from one country to another.
- a. Transfer payments
 - b. Factor income
 - c. The balance of trade
 - d. The balance of payments
 - e. The capital account

ANS: A PTS: 1

74. Which of the following is not a goal of the International Monetary Fund (IMF)?
- a. To promote cooperation among countries on international monetary issues
 - b. To promote stability in exchange rates

- c. To enhance a country's long-term economic growth via the extension of structural adjustment loans
- d. To promote free trade
- e. To promote free mobility of capital funds across countries

ANS: C PTS: 1

75. According to the "J curve effect," a weakening of the U.S. dollar relative to its trading partners' currencies would result in an initial ____ in the current account balance, followed by a subsequent ____ in the current account balance.
- a. decrease; increase
 - b. increase; decrease
 - c. decrease; decrease
 - d. increase; increase

ANS: A PTS: 1