

Chapter 2 World Trade and the International Monetary System

Notes to instructors:

Answers to non-numeric multiple choice questions are arranged alphabetically, so that answers are randomly assigned to the five outcomes.

True/False

1. Markets are integrated when an asset sells for the same price wherever it is traded.
True.
2. The world's financial markets are becoming increasingly segmented as large international commercial banks achieve more and more economic power.
False. They are becoming increasingly integrated (that is, less segmented).
3. Prices in the world's financial markets are becoming increasingly segmented as local political forces work to erect trade barriers to protect their local industries.
False. Although there remain local barriers, international markets for goods, services, and financial products are becoming more integrated (less segmented).
4. The international monetary system refers to the global network of governmental and commercial institutions within which currency exchange rates are determined.
True.
5. The International Monetary Fund's principal mission is to provide funds for economic development in developing economies.
False. The IMF's role is to help countries defend their currencies against temporary balance-of-payments imbalances and to promote cross-border trade.
6. The Basel Accord established the International Monetary Fund and the World Bank.
False. These institutions were established by the Bretton Woods Agreement of 1946.
7. The *financial account* of the IMF's *Balance-of-Payments Statistics* measures the total financial wealth of citizens in each reporting country.
False. The financial account measures cross-border transactions associated with changes in ownership of financial assets and liabilities.
8. The *trade balance* of the IMF's *Balance-of-Payments Statistics* is the net balance (exports minus imports) on merchandise trade.
True.
9. The *trade balance* of the IMF's *Balance-of-Payments Statistics* measures gross exports of goods and services.
False. The trade balance is the net balance on merchandise trade.
10. In a fixed exchange rate system, governments stand ready to buy and sell currency at official exchange rates.
True.
11. Decreases in currency values within a fixed rate system are called devaluations.
True.
12. Decreases in currency values within a floating rate system are called devaluations.
False. A decrease in a currency value in a floating rate system is called a depreciation.
13. Special drawing rights (SDRs) are distributed to commercial banks within the European Union (EU) in proportion to that member's proportion of EU trade.
False. SDRs are IMF bookkeeping units of account that are traded only between central banks.
14. Moral hazard is the risk that the existence of a contract will change the behaviors of parties to the

contract.

True.

15. IMF loans to troubled economies are unlikely to change the behaviors of investors, because investors can assess the risks of moral hazard for themselves.
False. The expectation of an IMF bailout creates a moral hazard, in that it changes the expectations and hence the behaviors of lenders, borrowers, and governments.
16. A subprime CDO is a collateralized debt obligation with a yield (i.e., a market interest rate) that is below the prime lending rate.
False. Subprime CDOs are poor credit risks, and carry higher interest rates than prime.
17. Liquidity refers to the ease with which an asset can be exchanged for another asset of equal value.
True.

Multiple Choice

Select the BEST ANSWER

1. Factors contributing to market segmentation include each of the following EXCEPT ____.
- a. informational barriers
 - b. regulatory and institutional interference
 - c. the immobility of human labor
 - d. transactions costs
 - * e. All of the above contribute to market segmentation.
2. The ____ of the IMF's *Balance-of-Payments Statistics* measures whether a particular country is a net importer or exporter of manufactured goods.
- a. current account
 - b. financial account
 - c. overall balance
 - * d. trade balance
 - e. none of the above
3. The ____ of the IMF's *Balance-of-Payments Statistics* measures whether a particular country is a net importer or exporter of goods and services.
- * a. current account
 - b. financial account
 - c. overall balance
 - d. trade balance
 - e. none of the above
4. The ____ of the IMF's *Balance-of-Payments Statistics* measures cross-border transactions associated with changes in ownership of financial assets and liabilities.
- a. current account
 - * b. financial account
 - c. overall balance
 - d. trade balance
 - e. none of the above
5. The ____ of the IMF's *Balance-of-Payments Statistics* measures the sum of all private financial and economic transactions of the reporting economy with the rest of the world.
- a. current account
 - b. financial account
 - * c. overall balance
 - d. trade balance
 - e. none of the above
6. Which of the following is not related to changes in currency values under managed exchange rate systems?
- a. business cycles

- b. inflation differentials
- c. politics
- d. the balance of payments
- * e. Each of the above is related to changes in currency values in managed systems.

7. When fixed exchange rate systems collapse, government officials most frequently blame ____ for precipitating the collapse.
- * a. currency speculators
 - b. foreign governments
 - c. multinational corporations
 - d. opposition politicians and their policies
 - e. themselves
8. The problem with a fixed exchange rate system is that ____.
- a. domestic inflation is directly linked to inflation in other countries
 - b. fixed exchange rates are hard to maintain when they diverge from market values
 - c. labor conditions are isolated from the rest of the world
 - d. all of the above
 - * e. two of the above
9. The ____ established the World Bank and the International Monetary Fund in 1946.
- a. Basel Accord
 - * b. Bretton Woods agreement
 - c. Louvre Accord
 - d. Plaza Accord
 - e. Treaty of Maastricht
10. Which of the following currencies is currently linked to the price of gold?
- a. British pound
 - b. Japanese yen
 - c. U.S. dollar
 - d. all of the above
 - * e. none of the above
11. Which of the following countries is currently participating in the single-currency Eurozone?
- a. Denmark
 - * b. Portugal
 - c. Sweden
 - d. Switzerland
 - e. United Kingdom
12. Which of the following was least likely to have caused the Mexican peso crisis of 1995?
- a. a shortage of foreign currency reserves at the Mexican central bank
 - * b. a weak economy
 - c. an inflated value of the peso caused by pegged exchange rates
 - d. short-term dollar borrowings by Mexican commercial banks and the government
 - e. All of the above contributed to the crisis.
13. Which of the following was most affected by the Asian contagion of 1997?
- a. China
 - * b. Korea
 - c. Japan
 - d. Singapore
 - e. Taiwan
14. Which of the following was least affected by the Asian contagion of 1997?
- * a. China
 - b. Korea
 - c. Indonesia
 - d. Thailand
 - e. the International Monetary Fund

15. Financial aid packages provided by the IMF to countries in a currency crisis are often tied to reforms that include ____.
- a. a coup d'état
 - b. changes in ruling parties
 - * c. financial market liberalizations
 - d. imposition of military rule to reestablish stability
 - e. none of the above
16. Common elements in many currency crises include each of the following EXCEPT:
- a. a fixed exchange rate system that overvalued the local currency
 - b. a large amount of foreign currency debt
 - c. a precipitous drop in the value of the local currency
 - d. IMF intervention to provide short-term assistance
 - * e. All of the above are common during currency crises.
17. Critics of IMF lending policies during financial crises favor which of (a) through (d)?
- a. fiscal restraint
 - b. immediate financial market liberalization
 - c. monetary restraint
 - d. temporary IMF loans
 - * e. Critics are against each of these policies.
18. Causes of the global financial crisis of 2008 included each of the following EXCEPT ____.
- a. a lack of financial market liquidity
 - b. a lack of regulatory oversight of mortgage lending
 - c. lax credit requirements for U.S. homeowners
 - d. subprime loans of poor credit quality
 - * e. the divergence in economic performance between developed and emerging market economies
19. One of the first symptoms of the 2008 financial crisis was ____.
- a. a decrease in the default risk of collateralized debt obligations (CDOs)
 - b. currency market volatility
 - c. a wave of corporate bankruptcies and government bailouts
 - d. government intervention in the currency markets
 - * e. illiquidity in the market for collateralized debt obligations (CDOs)