

Chapter 2

International Flow of Funds

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

ANSWER: D

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.
A) increase; increase
B) increase; decrease
C) decrease; decrease
D) decrease; increase

ANSWER: C

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).
A) decrease
B) increase
C) remain unaffected
D) either A or C are possible

ANSWER: B

4. _____ purchases more U.S. exports than any other country.
A) Japan
B) United Kingdom
C) Mexico
D) Canada

ANSWER: D

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

ANSWER: B

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).
- A) increase
 - B) have no impact on
 - C) reduce
 - D) all of the above are equally possible

ANSWER: C

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.

ANSWER: D

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.

ANSWER: B

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.

ANSWER: C

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.

ANSWER: E

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.

ANSWER: B

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.

ANSWER: B

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

ANSWER: D

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.

ANSWER: D

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.

ANSWER: B

16. The direct foreign investment positions by U.S. firms have generally _____ over time; the direct foreign investment positions in the U.S. by non-U.S. firms have generally _____ over time.
- A) increased; increased
 - B) increased; decreased
 - C) decreased; decreased
 - D) decreased; increased

ANSWER: A

17. Which of the following is the biggest target of direct foreign investment by U.S. firms?
- A) Mexico.
 - B) Japan.
 - C) United Kingdom.
 - D) Germany.

ANSWER: C

18. The primary component of the current account is the:
- A) balance of trade.
 - B) balance of money market flows.
 - C) balance of capital market flows.
 - D) unilateral transfers.

ANSWER: A

19. As a result of the European Union, restrictions on exports between _____ were reduced or eliminated.
- A) member countries and the U.S.
 - B) member countries
 - C) member countries and European non-members
 - D) none of the above

ANSWER: B

20. Over time, international trade (exports plus imports) as a percentage of GDP has:
- A) increased for most major countries.
 - B) decreased for most major countries.
 - C) stayed about constant for most major countries.
 - D) increased for about half the major countries and decreased for the others.

ANSWER: A

21. Which is not a concern about the North American Free Trade Agreement (NAFTA)?
- A) its impact on U.S. inflation.
 - B) its impact on U.S. unemployment.
 - C) lower environmental standards in Mexico.
 - D) different health laws for workers in Mexico.

ANSWER: A

22. A General Agreement on Tariffs and Trade (GATT) accord in 1993 called for:
- A) increased trade restrictions outside of North America.
 - B) lower trade restrictions around the world.
 - C) uniform environmental standards around the world.
 - D) uniform worker health laws.

ANSWER: B

23. Which of the following is not a commonly occurring subtle trade restriction?
- A) Firms based in one country are not subject to certain restrictions and can produce products at a lower cost than firms in other countries.
 - B) Firms based in a country receive subsidies from their government, produce products, and then export those products at a cheap price.
 - C) Firms based in one country are allowed by their government to offer bribes to large customers when pursuing business deals in a particular industry.
 - D) All of the above describe commonly occurring subtle trade restrictions.

ANSWER: D

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

ANSWER: B

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.

ANSWER: D

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

ANSWER: D

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.

ANSWER: D

28. Intracompany trade makes up approximately _____ percent of all international trade.
- A) 50
 - B) 70
 - C) 25
 - D) 13
 - E) 5

ANSWER: A

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)

ANSWER: B

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.

ANSWER: E

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)

ANSWER: E

32. Direct foreign investment into the U.S. represents a _____.
- A) capital inflow
 - B) trade inflow
 - C) capital outflow
 - D) trade outflow

ANSWER: A

33. A balance-of-trade surplus indicates an excess of merchandise imports over merchandise exports.
- A) true.
 - B) false.

ANSWER: B

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.
- A) true.
 - B) false.

ANSWER: B

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.

ANSWER: B

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.

ANSWER: A

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.

ANSWER: A

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.

ANSWER: A

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.

ANSWER: A

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.

ANSWER: B

41. Exporting of products by one country to other countries at prices below cost is called elasticity.

A) true.
B) false.

ANSWER: B

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

A) true.
B) false.

ANSWER: B

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.

ANSWER: A

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.

ANSWER: A

45. Intracompany trade represents the exporting of products by one country to other countries below cost.
- A) true.
 - B) false.

ANSWER: B

46. A tariff is a maximum limit on imports.
- A) true.
 - B) false.

ANSWER: B