

# 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 decrease or remain unaffected

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 these 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) China and Japan.
  - D) none of these.

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 these.

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 these

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. A possible means, mentioned in the text, by which the government may attempt to improve its balance of trade position (increase its exports or reduce its imports) is:
- A) it could attempt to strengthen its local currency value.
  - 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 these are mentioned.

ANSWER: A

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 these

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 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

ANSWER: A

34. 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

ANSWER: D

35. 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

ANSWER: B

36. 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

ANSWER: C

37. 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

ANSWER: D

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

ANSWER: B

39. 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.

ANSWER: B

40. 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

41. 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



42. 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

43. 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

44. 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

45. 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

46. Exporting of products by one country to other countries at prices below cost is called elasticity.  
A) true.  
B) false.

ANSWER: B

47. Direct foreign investment by U.S.-based MNCs occurs primarily in the Bahamas and Brazil.  
A) true.  
B) false.

ANSWER: B

48. 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

49. 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

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

ANSWER: B

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

ANSWER: B

52. 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.

ANSWER: A

53. 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.

ANSWER: B

54. Regarding the U.S. balance of payments, capital account items are relatively minor compared to the financial account items.
- A) true.
  - B) false.

ANSWER: A

55. 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.

ANSWER: B

56. In July 2005, China established a new currency to replace the yuan.  
A) true.  
B) false.

ANSWER: B

57. In July 2005, China shifted its exchange rate system so that the yuan was allowed to fluctuate within limits.  
A) true.  
B) false.

ANSWER: A