Assignment 12 (Chapter 13)

1. The balance-of-payments adjustment mechanism developed during the 1700s by the English economist David Hume is the:
   a) Income-adjustment mechanism
   b) Flexible-exchange-rate-adjustment mechanism
   c) Price-adjustment mechanism
   d) Rank-reserve-adjustment mechanism

2. Which chain of events would promote payments equilibrium for a **deficit** nation, according to the price-adjustment mechanism?
   a) Increasing money supply-increasing domestic prices-rising imports-falling exports
   b) Increasing money supply-falling domestic prices-rising imports-falling exports
   c) Decreasing money supply-increasing domestic prices-falling imports-rising exports
   d) Decreasing money supply-decreasing domestic prices-falling imports-rising exports

3. During the gold standard era, the "rules of the game" suggested that:
   a) Surplus countries should increase their money supplies
   b) Deficit countries should increase their money supplies
   c) Surplus and deficit countries should increase their money supplies
   d) Surplus and deficit countries should decrease their money supplies

4. Which of the following balance-of-payments adjustment mechanisms is **most closely** related to the quantity theory of money?
   a) Income-adjustment mechanism
   b) Price-adjustment mechanism
   c) Interest-rate-adjustment mechanism
   d) Output-adjustment mechanism

5. Under the gold standard, a **surplus** nation facing a gold **inflow** and an **increase** in its money supply would also experience a:
   a) Rise in its interest rate and a short-term financial inflow
   b) Rise in its interest rate and a short-term financial outflow
   c) Fall in its interest rate and a short-term financial inflow
   d) Fall in its interest rate and a short-term financial outflow

6. Under the gold standard, a **deficit** nation facing a gold **outflow** and a **decrease** in its money supply would also experience a:
   a) Rise in its interest rate and a short-term financial inflow
   b) Rise in its interest rate and a short-term financial outflow
   c) Fall in its interest rate and a short-term financial inflow
   d) Fall in its interest rate and a short-term financial outflow
7. Assume that Canada initially faces payments equilibrium in its merchandise trade account as well as in its capital and financial account. Now suppose that Canadian interest rates fall to levels below those abroad. For Canada, this tends to promote:

a) Net financial inflows  
b) Net financial outflows  
c) Net merchandise exports  
d) Net merchandise imports

8. Suppose Japan increases its imports from Sweden, leading to a rise in Sweden's exports and income level. With a higher income level, Sweden imports more goods from Japan. Thus, a change in imports in Japan results in a feedback effect on its exports. This process is best referred to as the:

a) Monetary approach to balance-of-payments adjustment  
b) Discretionary income adjustment process  
c) Foreign repercussion effect  
d) Price-specie-flow mechanism

9. The monetary approach to balance-of-payments adjustments suggests that all payments deficits are the result of:

a) Too high interest rates in the home country  
b) Too low interest rates in the home country  
c) Excess money supply over money demand in the home country  
d) Excess money demand over money supply in the home country

10. The monetary approach to balance-of-payments adjustments suggests that all payments surpluses are the result of:

a) Too high interest rates in the home country  
b) Too low interest rates in the home country  
c) Excess money supply over money demand in the home country  
d) Excess money demand over money supply in the home country

11. Starting from a position where the nation's money demand equals the money supply and its balance of payments is in equilibrium, economic theory suggests that the nation's balance of payments would move into a deficit position if there occurred in the nation:

a) A decrease in the money supply  
b) An increase in the money demand  
c) A decrease in the money demand  
d) None of the above
12. According to the "rules of the game" of the gold standard era, a country's central bank agreed to react to international gold flows so as to:

   a) Officially devalue a currency during eras of payments surpluses
   b) Officially revalue a currency during eras of payments deficits
   c) Offset the automatic-adjustment mechanism (e.g., prices)
   d) Reinforce the automatic-adjustment mechanism

13. The formulation of the so-called income adjustment mechanism is associated with:

   a) Adam Smith
   b) David Ricardo
   c) David Hume
   d) John Maynard Keynes

14. Starting from a position where the nation's money demand equals the money supply and its balance of payments is in equilibrium, economic theory suggests that the nation's balance of payments would move into a **deficit** position if there occurred in the nation:

   a) An increase in the money supply
   b) A decrease in the money supply
   c) An increase in money demand
   d) None of the above

15. Starting from a position where the nation's money demand equals the money supply and its balance of payments is in equilibrium, economic theory suggests that the nation's balance of payments would move into a **surplus** position if there occurred in the nation:

   a) An increase in the money demand
   b) A decrease in the money demand
   c) An increase in the money supply
   d) None of the above

16. Assume identical interest rates on comparable securities in the United States and foreign countries. Suppose investors anticipate that in the future the U.S. dollar will **depreciate** against foreign currencies. Investment funds would tend to:

   a) Flow from the United States to foreign countries
   b) Flow from foreign countries to the United States
   c) Remain totally in foreign countries
   d) Remain totally in the United States
17. Use the graph shown in Figure 13.1 to answer the question(s).

**Figure 13.1. U.S. Capital and Financial Account**

Refer to Figure 13.1. Downward movements along U.S. capital and financial account schedule CA₀ would be caused by:

a) U.S. interest rates rising relative to foreign interest rates  
b) U.S. interest rates falling relative to foreign interest rates  
c) Taxes placed on income earned by U.S. residents from their foreign investments  
d) Taxes placed on income earned by foreign residents from their U.S. investments

18. J. M. Keynes suggested that a trade deficit nation:

a) Would experience a fall in income  
b) Would experience a decline in imports  
c) Would require active intervention by the government  
d) Both a and b

19. The classical gold standard:

a) Existed from early 1800s to early 1900s  
b) Did not allow for imports and exports of gold  
c) Led to the outflow of gold from surplus nations  
d) Led to the inflow of gold to deficit nations

20. Which of the following does **not** represent an **automatic** adjustment in balance-of-payments disequilibrium? Variations in:

a) Domestic income  
b) Foreign prices  
c) Domestic prices  
d) Foreign par values
21. Which chain of events would promote payments equilibrium for a surplus nation, according to the price-adjustment mechanism?

a) Increasing money supply-increasing domestic prices-rising imports-falling exports
b) Increasing money supply-falling domestic prices-rising imports-falling exports
c) Decreasing money supply-increasing domestic prices-falling imports-rising exports
d) Decreasing money supply-decreasing domestic prices-falling imports-rising exports

22. Which approach to balance-of-payments adjustment suggests that balance-of-payments surpluses are the result of excess money demand in the home country?

a) Absorption approach
b) Elasticities approach
c) Monetary approach
d) Purchasing-power-parity approach

23. The monetary approach contends that, under a fixed exchange-rate system, an excess supply of money leads to a trade surplus.

a) True
b) False

24. Prices, interest rates, and income are the automatic adjustment variables that help restore current-account equilibrium under a system of fixed exchange rates.

a) True
b) False

25. Under the gold standard, a nation with a current-account surplus would realize gold outflows, a decrease in its money supply, and a fall in its domestic price level.

a) True
b) False