

I. Multiple Choice

1. The balance of payments accounts must always sum to:
 - A. A positive number
 - B. A negative number
 - C. Zero
 - D. The GDP of the country
2. Which of the following is recorded in the current account?
 - A. Purchase of foreign stocks
 - B. Export of automobiles
 - C. Foreign direct investment
 - D. Changes in official reserves
3. A country has exports of \$200 billion, imports of \$250 billion, net income receipts of \$30 billion, and net transfers of -\$10 billion. What is the current account balance?
 - A. -\$30 billion
 - B. -\$20 billion
 - C. \$20 billion
 - D. \$30 billion
4. If a country has a current account deficit, it must have:
 - A. A financial account deficit
 - B. A financial account surplus
 - C. Balanced trade
 - D. A government budget surplus
5. Which transaction would be recorded as a credit in the US current account?
 - A. An American buys a Japanese car
 - B. An American tourist visits France
 - C. A German company buys a US factory
 - D. A Japanese tourist visits New York
6. Foreign direct investment is recorded in:
 - A. The current account
 - B. The financial account
 - C. The merchandise trade balance
 - D. Net transfers
7. If the exchange rate changes from \$1.20/€ to \$1.10/€, the dollar has:
 - A. Depreciated

- B. Appreciated
 - C. Remained constant
 - D. Been devalued
8. In the foreign exchange market for euros, an increase in US demand for European goods will:
- A. Shift euro demand right, causing euro appreciation
 - B. Shift euro demand left, causing euro depreciation
 - C. Shift euro supply right, causing euro depreciation
 - D. Have no effect on the euro exchange rate
9. If US interest rates rise relative to European interest rates, the dollar will likely:
- A. Depreciate as capital flows to Europe
 - B. Appreciate as capital flows to the US
 - C. Remain unchanged
 - D. Be fixed by the Federal Reserve
10. If US inflation is higher than European inflation, *ceteris paribus*:
- A. The dollar will appreciate
 - B. The dollar will depreciate
 - C. The euro will depreciate
 - D. Exchange rates will not change
11. When a currency appreciates:
- A. Exports become cheaper and imports become more expensive
 - B. Exports become more expensive and imports become cheaper
 - C. Both exports and imports become cheaper
 - D. Both exports and imports become more expensive
12. The J-curve effect refers to:
- A. The immediate improvement in trade balance after depreciation
 - B. The worsening of trade balance before eventual improvement after depreciation
 - C. The shape of the exchange rate over time
 - D. The relationship between interest rates and exchange rates
13. Currency depreciation will most likely:
- A. Reduce inflation and increase net exports
 - B. Increase inflation and reduce net exports
 - C. Increase inflation and increase net exports
 - D. Reduce inflation and reduce net exports
14. Who benefits from domestic currency appreciation?
- A. Domestic exporters
 - B. Domestic consumers buying imports
 - C. Import-competing industries

D. Workers in export industries

15. The relationship between net exports and capital flows is:

- A. $NX = \text{Net Capital Inflows}$
- B. $NX = -\text{Net Capital Inflows}$
- C. NX and capital flows are unrelated
- D. $NX > \text{Net Capital Inflows}$ always

16. If a country has a trade surplus, it must be:

- A. Borrowing from abroad
- B. Lending to abroad
- C. Running a government deficit
- D. Experiencing inflation

17. According to the national saving-investment identity, a current account deficit occurs when:

- A. Saving exceeds investment
- B. Investment exceeds saving
- C. Government spending exceeds taxes
- D. Exports exceed imports

18. The twin deficits hypothesis links:

- A. Trade deficits and unemployment
- B. Budget deficits and current account deficits
- C. Inflation and unemployment
- D. Investment and saving

19. A tariff on imported goods will:

- A. Reduce domestic prices
- B. Increase consumer surplus
- C. Decrease imports
- D. Reduce government revenue

20. The deadweight loss from a tariff results from:

- A. Government revenue collection
- B. Increased producer surplus
- C. Production and consumption inefficiency
- D. Decreased imports only

21. Compared to a tariff, a quota:

- A. Generates government revenue
- B. Creates quota rents for license holders
- C. Has no deadweight loss
- D. Always improves welfare

22. The infant industry argument for protection suggests:
- A. All new industries should be permanently protected
 - B. Temporary protection helps new industries develop scale
 - C. Old industries need protection from young competitors
 - D. Protection reduces innovation
23. Which is the strongest economic argument for free trade?
- A. It protects domestic jobs
 - B. It allows specialization according to comparative advantage
 - C. It reduces inequality
 - D. It increases government revenue
24. Trade policy is often more protectionist than economic efficiency suggests because:
- A. Benefits are concentrated and costs are diffuse
 - B. Consumers lobby for protection
 - C. Tariffs have no deadweight loss
 - D. Free trade harms all parties
25. Globalization has been accelerated by:
- A. Technological advances reducing transportation costs
 - B. Increased trade barriers
 - C. Decreased capital mobility
 - D. Isolationist policies
26. A major cost of globalization is:
- A. Lower consumer prices
 - B. Job displacement in import-competing industries
 - C. Increased product variety
 - D. Economic growth
27. Global imbalances refer to:
- A. Unequal income distribution within countries
 - B. Large, persistent current account surpluses and deficits
 - C. Exchange rate fluctuations
 - D. Differences in GDP growth rates
28. The International Monetary Fund (IMF) primarily:
- A. Provides long-term development loans
 - B. Enforces trade agreements
 - C. Provides crisis assistance and promotes monetary cooperation
 - D. Regulates multinational corporations
29. Currency manipulation involves:
- A. Allowing currencies to float freely

- B. Artificially weakening currency to boost exports
 - C. Appreciating currency to reduce inflation
 - D. Eliminating exchange rate controls
30. A trade war occurs when:
- A. Countries remove all trade barriers
 - B. Countries retaliate against each other's protectionist policies
 - C. Exchange rates fluctuate
 - D. Free trade agreements are signed
31. If a country's currency is expected to appreciate in the future:
- A. Current demand for the currency decreases
 - B. Current demand for the currency increases
 - C. Current supply of the currency increases
 - D. The exchange rate remains unchanged
32. Under a fixed exchange rate system
- A. Market forces determine exchange rates
 - B. The central bank must intervene to maintain the rate
 - C. Exchange rates fluctuate freely
 - D. No reserves are needed
33. A managed float exchange rate system involves:
- A. Completely fixed rates
 - B. Complete market determination
 - C. Mostly floating with occasional intervention
 - D. No government involvement
34. Which would cause the supply of dollars to increase in the foreign exchange market?
- A. Increased US demand for foreign goods
 - B. Decreased foreign demand for US goods
 - C. Higher US interest rates
 - D. Lower US inflation
35. Portfolio investment differs from foreign direct investment in that portfolio investment:
- A. Involves long-term control
 - B. Involves buying stocks/bonds without control
 - C. Is always more stable
 - D. Is recorded in the current account
36. If $S - I = -\$100$ billion, the current account balance is:
- A. +\$100 billion
 - B. -\$100 billion
 - C. \$0

- D. Cannot be determined
37. An increase in government budget deficit will most likely:
- A. Improve the current account
 - B. Worsen the current account
 - C. Have no effect on the current account
 - D. Cause currency appreciation
38. A quota is economically worse than an equivalent tariff when:
- A. Government collects the quota rent
 - B. Foreign exporters receive the quota rent
 - C. Domestic consumers receive the quota rent
 - D. Quotas are always better than tariffs
39. The World Trade Organization (WTO) primarily:
- A. Provides development financing
 - B. Offers crisis loans to countries
 - C. Enforces trade agreements and resolves disputes
 - D. Manages exchange rates
40. Which is a benefit of globalization?
- A. Increased job protection
 - B. Lower product variety
 - C. Poverty reduction in developing countries
 - D. Reduced capital mobility

II. True / False

41. The balance of payments must always equal zero by accounting identity.
42. A current account surplus means a country is borrowing from abroad.
43. Exports are recorded as credits in the current account.
44. Foreign direct investment is recorded in the current account.
45. If the dollar appreciates against the euro, the euro depreciates against the dollar.
46. Currency appreciation makes a country's exports more competitive internationally.
47. An increase in US income will increase demand for foreign currency.

48. Higher domestic interest rates attract foreign capital, causing currency appreciation.
49. The J-curve effect means trade balance improves immediately after depreciation.
50. Currency depreciation tends to increase inflation through higher import prices.
51. Domestic consumers benefit from currency appreciation.
52. A trade deficit necessarily indicates economic weakness.
53. Net exports equal negative net capital inflows.
54. A current account deficit requires investment to exceed saving.
55. The twin deficits hypothesis links budget deficits to current account deficits.
56. Tariffs increase consumer surplus.
57. Quotas generate government revenue like tariffs do.
58. The deadweight loss from tariffs results from production and consumption inefficiency.
59. The infant industry argument supports permanent protection for all new industries.
60. Free trade allows countries to specialize according to comparative advantage.
61. Protection typically benefits concentrated interests at the expense of diffuse consumers.
62. Globalization has reduced poverty in many developing countries.
63. Job displacement is a cost of globalization.
64. Financial globalization has made economies less interconnected.
65. Global imbalances pose no economic risks.
66. The IMF provides long-term development financing like the World Bank.
67. Currency manipulation involves artificially weakening currency to gain trade advantages.
68. Trade wars benefit all participating countries.
69. Under floating exchange rates, market forces determine currency values.

70. A fixed exchange rate system requires no government intervention.

III. Fill in the Blank

71. The balance of payments consists of the _____ account and the _____ account.

72. A country's exports minus imports of goods is called the _____ trade balance.

73. The current account records transactions in goods, services, income, and _____.

74. By accounting identity, Current Account + Financial Account = _____.

75. If a currency becomes more valuable, it has _____.

76. If a currency becomes less valuable, it has _____.

77. In the foreign exchange market, the price of one currency in terms of another is the _____ rate.

78. When US interest rates rise relative to foreign rates, the dollar will likely _____.

79. The _____ effect describes how trade balance initially worsens then improves after depreciation.

80. Currency _____ makes exports more expensive and imports cheaper.

81. Currency _____ makes exports cheaper and imports more expensive.

82. The relationship between net exports and capital flows is: $NX =$ _____ Net Capital Inflows.

83. A trade surplus implies net capital _____ (inflows/outflows).

84. According to the national saving identity, $CA =$ _____ - _____.

85. The twin deficits hypothesis links government _____ deficits to current account deficits.

86. A _____ is a tax on imported goods.

87. A _____ is a quantitative restriction on imports.

88. Tariffs create _____ loss from production and consumption inefficiency.

89. Unlike tariffs, quotas create _____ rents instead of government revenue.
90. The _____ industry argument suggests temporary protection helps new industries develop.
91. Trade policy tends to be protectionist because benefits are _____ while costs are _____.
92. _____ describes increasing integration of economies through trade and finance.
93. Global _____ refer to large, persistent current account surpluses and deficits.
94. The _____ provides crisis assistance and promotes monetary cooperation.
95. The _____ enforces trade agreements and resolves trade disputes.
96. Currency _____ involves artificially weakening currency to boost exports.
97. A trade _____ occurs when countries retaliate with escalating protectionist policies.
98. Under a _____ exchange rate system, market forces determine currency values.
99. Under a _____ exchange rate system, the government maintains specific rates through intervention.
100. A _____ float involves mostly market determination with occasional government intervention.

IV. Matching

101. Match each term to the appropriate description.

Term	Description
A. Merchandise trade B. Services C. Income receipts D. Current transfers E. Foreign direct investment F. Portfolio investment G. Reserve assets H. Current account deficit I. Financial account surplus J. Trade surplus	1. Exports and imports of physical goods 2. Tourism, financial services, consulting 3. Investment income earned abroad 4. One-way transfers like foreign aid 5. Long-term investment with control 6. Buying stocks/bonds without control 7. Central bank holdings of foreign currency 8. Spending more abroad than earning 9. More capital inflows than outflows 10. Exports exceed imports

102. Match each cause to its effect.

Cause	Effect
A. Currency appreciation B. Currency depreciation C. Higher domestic interest rates D. Higher domestic inflation E. Increased domestic income F. Expected future appreciation G. Central bank sells domestic currency H. Floating exchange rate	1. Currency appreciates 2. Currency depreciates 3. Imports become cheaper 4. Exports become cheaper 5. Demand for foreign currency increases 6. Market forces determine rate 7. Currency depreciates immediately 8. Immediate currency appreciation

103. Match the trade policy with its characteristics.

Policy	Characteristic
A. Tariff B. Quota C. Subsidy D. Deadweight loss E. Infant industry argument F. National security argument G. Comparative advantage H. Global imbalances	9. Tax on imports 10. Quantitative restriction on imports 11. Government payment to producers 12. Lost efficiency from protection 13. Temporary protection for new industries 14. Protection for strategic industries 15. Basis for gains from trade 16. Large persistent current account surpluses/deficits

V. Short Answer

104. Explain the difference between the current account and the financial account.
105. Why must the balance of payments always sum to zero?
106. How is a US export of aircraft to Japan recorded in the US balance of payments?
107. Explain the relationship between a current account deficit and a financial account surplus.
108. What does it mean for a currency to appreciate? Provide an example with exchange rates.
109. Explain why demand for a foreign currency slopes downward in the forex market.
110. How do higher domestic interest rates affect exchange rates?
111. What is the J-curve effect and why does it occur?

112. How does currency appreciation affect a country's inflation rate?
113. Explain who benefits and who is harmed by currency depreciation.
114. What is the relationship between net exports and net capital flows?
115. According to the national saving identity ($CA = S - I$), when does a current account deficit occur?
116. Explain the twin deficits hypothesis.
117. How does a tariff affect consumer surplus, producer surplus, and total welfare?
118. Why do quotas create quota rents instead of government revenue?
119. Explain the infant industry argument for protection and one critique of it.
120. Why does trade policy tend to be more protectionist than economic efficiency suggests?
121. Name three benefits of globalization.
122. Name three costs or challenges of globalization.
123. What are global imbalances and why are they concerning?
124. What is currency manipulation and how is it accomplished?
125. What is a trade war and what are its economic effects?
126. Compare floating and fixed exchange rate systems.
127. How does an increase in US income affect the dollar exchange rate?
128. Why might a country with a trade deficit not be economically weak?
129. Explain how tariffs create deadweight loss.
130. What role does the World Trade Organization (WTO) play?

VI. Calculations

131. A country has the following international transactions (in billions): - Exports of goods: \$300 - Imports of goods: \$400 - Exports of services: \$100 - Imports of services: \$80 - Net income receipts: \$30 - Net transfers: -\$20
- Calculate the merchandise trade balance.
 - Calculate the services balance.
 - Calculate the current account balance.
132. A country has a current account deficit of \$150 billion. What must be true about its financial account balance?
133. The exchange rate changes from €0.90/\$ to €0.85/\$.
- Has the dollar appreciated or depreciated?
 - Has the euro appreciated or depreciated?
 - Express the new exchange rate in \$/€ terms.
134. The exchange rate is \$1.25/€. An American wants to buy a German car that costs €40,000. How many dollars does it cost?
135. After the dollar appreciates, the exchange rate changes from \$1.25/€ to \$1.15/€. How much does the €40,000 car now cost in dollars? Did it become cheaper or more expensive for Americans?
136. A country has national savings of \$500 billion and domestic investment of \$600 billion.
- Calculate the current account balance.
 - Is the country borrowing from or lending to the rest of the world?
137. A country has a government budget deficit of \$200 billion. Private saving exceeds private investment by \$150 billion.
- Calculate the current account balance.
 - Is this an example of twin deficits?
138. A tariff raises the domestic price of imports from \$100 to \$120. Imports fall from 1,000 units to 800 units.
- Calculate the tariff per unit.
 - Calculate government tariff revenue.
139. Before a tariff, consumer surplus is \$10,000 and producer surplus is \$5,000. After the tariff, consumer surplus is \$7,000, producer surplus is \$6,500, and government revenue is \$1,600.
- Calculate total surplus before the tariff.
 - Calculate total surplus after the tariff (CS + PS + Government Revenue).
 - Calculate the deadweight loss.
140. A country's exports are \$800 billion and imports are \$900 billion.
- Calculate net exports.

- b. What must be true about net capital flows?
 - c. Is the country borrowing from or lending to the world?
141. The equilibrium exchange rate in the euro market is \$1.20/€. The European Central Bank wants to weaken the euro to \$1.15/€. Should it buy or sell euros? Explain using supply and demand.
142. US income increases, causing Americans to import more European goods. Show what happens to:
- a. Demand for euros
 - b. The equilibrium exchange rate (\$/€)
 - c. The value of the dollar
143. A country imposes a \$10 tariff on imported steel. Before the tariff, the domestic price equals the world price of \$100, and 5,000 tons are imported. After the tariff, imports fell to 3,000 tons.
- a. What is the new domestic price?
 - b. What is government revenue?
 - c. How many tons did domestic production increase by?
144. Country A has a current account balance of +\$200 billion. Country B has a current account balance of -\$150 billion.
- a. Which country is lending to the rest of the world?
 - b. Which country has a financial account surplus?
145. The exchange rate is 110 yen/\$. A Japanese car costs ¥3,300,000. How many dollars does it cost? If the dollar depreciates to 100 yen/\$, what is the new dollar price?

VII. Graphing Practice

146. Draw a foreign exchange market graph for euros (€):
- a. Label axes (\$/€ on vertical, quantity of € on horizontal).
 - b. Draw supply and demand curves.
 - c. Show equilibrium exchange rate.
 - d. Show what happens when US demand for European goods increases.
 - e. Indicate whether the euro appreciates or depreciates.
147. Draw a foreign exchange market graph showing the effect of increased US interest rates on the dollar:
- a. Show initial equilibrium.
 - b. Shift appropriate curves.
 - c. Show the new exchange rate.
 - d. Indicate dollar appreciation.

148. Draw a supply and demand graph for an imported good with a tariff:
- Show world price and domestic price after tariff.
 - Indicate imports before and after tariff.
 - Shade consumer and producer surplus, government revenue, and deadweight loss post-tariff.
149. Draw a graph illustrating the J-curve effect:
- Put time on the horizontal axis, trade balance on the vertical axis.
 - Show initial deficit.
 - Show worsening in the short run after depreciation.
 - Show improvement in the long run.
 - Explain why the J-shape occurs.
150. Draw a foreign exchange market showing central bank intervention:
- Show equilibrium exchange rate.
 - If the central bank wants to weaken the domestic currency, show the intervention.
 - Indicate the new exchange rate.

VIII. Long Answer (IB Students Only)

151. Evaluate the following statement: "A current account deficit is always harmful to an economy." Discuss both perspectives and use economic reasoning. (15 marks)
152. Analyze the effects of currency appreciation on an economy. Consider impacts on trade, inflation, growth, and different economic groups. (15 marks)
153. Compare and contrast tariffs and quotas as instruments of trade policy. Evaluate which is more economically efficient. (12 marks)
154. Discuss the costs and benefits of globalization. Evaluate whether the benefits outweigh the costs. (15 marks)
155. Explain the twin deficits hypothesis and evaluate the extent to which government budget deficits cause current account deficits. (12 marks)
156. Using balance of payments accounting, explain why a trade deficit must be accompanied by net capital inflows. Discuss the implications of this relationship. (10 marks)
157. Analyze how changes in exchange rates affect different groups within an economy. Who are the winners and losers from currency depreciation? (12 marks)
158. Evaluate the infant industry argument for trade protection. Under what conditions might it be valid? What are the main critiques? (12 marks)

159. Discuss the role of the International Monetary Fund (IMF) in the global economy. Evaluate criticisms of IMF policies. (10 marks)
160. Explain what causes exchange rates to change over time. Analyze the relative importance of different determinants. (15 marks)