Chapter 17
The International Monetary System

Multiple Choice Questions

Choose the one alternative that best completes the statement or answers the question.

1. Foreign exchange is defined as
   (a) when a domestic resident exchanges goods with a foreigner.
   (b) using dollars to buy oil from Saudi Arabia.
   (c) bank deposits denominated in foreign currency.
   (d) using Euros to buy French wine.
   (e) All of the above.
   Answer: C

2. If a French wine costs 40 Euros and the U.S. dollar trades for $1.1940 per Euro,
   (a) the wine will cost $33.50.
   (b) the wine will cost $40.00.
   (c) the wine will cost $47.76.
   (d) the wine will cost $52.50.
   (e) None of the above.
   Answer: C

3. A Japanese CD player costs $30 in the U.S. and 3,304 Yen in Japan. What is the exchange rate?
   (a) 110.13 dollars equals 1 yen.
   (b) 110.13 yen equals 1 dollar.
   (c) 1 yen equals .91 dollars.
   (d) 1 dollar equals .0091 yen.
   (e) None of the above.
   Answer: B

4. If U.S. residents wish to invest in German companies,
   (a) the demand for foreign exchange shifts to the left and the Euro appreciates.
   (b) the demand for foreign exchange shifts to the right and the Euro appreciates.
   (c) the demand for foreign exchange shifts to the left and the Euro depreciates.
   (d) the demand for foreign exchange shifts to the right and the Euro depreciates.
   (e) the demand curve and foreign exchange are not affected.
   Answer: B
5. If German residents wish to sell U.S. stock and invest it in a German company,
   (a) the demand for foreign exchange shifts to the left and the Euro appreciates.
   (b) the demand for foreign exchange shifts to the left and the Euro depreciates.
   (c) the demand for foreign exchange shifts to the right and the Euro appreciates.
   (d) the demand for foreign exchange shifts to the right and the Euro depreciates.
   (e) the demand curve and foreign exchange are not affected.
   Answer: C

6. According to the theory of Purchasing Power Parity, if Japanese prices increase by 10 percent, while
   U.S. prices remain constant
   (a) Japanese goods are immediately less expensive in the U.S.
   (b) the demand for Japanese goods will rise.
   (c) the yen will depreciate.
   (d) the dollar will depreciate.
   (e) All of the above.
   Answer: C

7. A “cheap” U.S. dollar (with respect to the Chinese renminbi or yuan—the Chinese currency) means
   all of the following except
   (a) China can continue to employ their vast unemployed labor reserves.
   (b) China can continue to sell its products to the huge American market.
   (c) China can include more of their underemployed agricultural workers in the labor market.
   (d) China will continue to run a significant balance of payments surplus with the U.S.
   (e) All of the above are true.
   Answer: E

8. The foreign-exchange market is necessary because
   (a) exports give rise to a supply of foreign currencies.
   (b) imports give rise to a demand for foreign exchange.
   (c) international transactions involve different currencies.
   (d) individuals travel to other countries.
   (e) All of the above.
   Answer: E

9. If the American dollar appreciates relative to the British pound
   (a) British bicycles will become cheaper in the United States.
   (b) American wheat will become cheaper in Britain.
   (c) British bicycles will become more expensive in the United States.
   (d) Germany’s Mercedes-Benz will become cheaper in the United States.
   (e) None of the above.
   Answer: A
10. Under a floating exchange-rate system, if a country increases its imports by lowering tariffs and by increasing quotas, its currency
   (a) depreciates and exports rise.
   (b) depreciates and exports fall.
   (c) appreciates and exports rise.
   (d) appreciates and exports fall.
   (e) is unaffected.
Answer: A

11. Balance-of-payments deficits (measured by movements of gold) under the Hume gold-flow mechanism would be eliminated by
   (a) depreciating the currency.
   (b) a currency devaluation.
   (c) letting the outflow of gold reduce the money supply, resulting in lower wages and prices.
   (d) intervention in the foreign exchange market by the country’s central bank.
   (e) None of the above.
Answer: C

12. The balance of payments is a two-sided summary of a country’s
   (a) loss or gain of money from the rest of the world.
   (b) economic transactions with the rest of the world over a given period.
   (c) exchange rates with every other country.
   (d) GDP compared to other countries.
   (e) merchandise exports and imports.
Answer: B

13. The excess of saving over investment in a country is necessarily reflected in
   (a) an appreciation of the foreign-exchange rate.
   (b) an excess of exports over imports.
   (c) an excess of imports over exports.
   (d) changes in the money supply.
   (e) capital imports from other countries.
Answer: B

14. The present international monetary system is best described as
   (a) the Bretton Woods system set up after World War II.
   (b) fixed exchange rates with periodic adjustment.
   (c) a perfectly floating exchange-rate system.
   (d) a managed floating exchange rate system with IMF surveillance.
   (e) a gold standard.
Answer: D
15. The Bretton Woods system was set up on the theory that
(a) deficits were temporary and could be financed by international assistance.
(b) exchange rates would be used to achieve equilibrium.
(c) the gold standard would ultimately be restored.
(d) balance-of-payments deficits should be related to decreases in a country’s money supply.
(e) countries would willingly give up monetary autonomy to avoid balance of payments problems.
Answer: A

16. A demand for foreign exchange occurs in the United States when
(a) the United States exports wheat.
(b) foreigners travel in America.
(c) Americans invest in foreign countries.
(d) Americans receive dividends and interest on their European investments.
(e) an American travels to New York.
Answer: C

17. When a country’s currency depreciates relative to foreign currencies,
(a) each unit of the country’s currency buys less foreign exchange.
(b) each unit of foreign currency buys more of the country’s currency.
(c) its exports become cheaper to foreigners.
(d) foreign products become more expensive to the country’s residents.
(e) All of the above.
Answer: E

18. Under a floating exchange-rate system, equilibrium in the balance of payments
(a) is not possible.
(b) requires increasing the money supply when there is a surplus.
(c) occurs automatically.
(d) occurs when the government does not inflate or deflate.
(e) requires a country’s central bank to buy or sell its currency on foreign exchange markets.
Answer: C

19. Fixed exchange-rate systems maintained by a gold standard have difficulty achieving equilibrium if
(a) the money supply rises with surpluses.
(b) the money supply falls with deficits.
(c) inflation of costs and prices occurs with a balance-of-payments surplus.
(d) changes in the money supply are unrelated to the state of the balance of payments.
(e) All of the above.
Answer: D
20. Which of the following correctly completes this statement? Credit items in the balance of payments correspond to
(a) any item that demands foreign exchange.
(b) any item that supplies foreign exchange.
(c) import-like items.
(d) any item that increases the domestic money supply.
(e) any item that decreases the domestic money supply.
Answer: B

21. The correct relationship between exports (X), imports (M), domestic saving (S), and domestic investment (I) is
(a) $S + X = M + I$.
(b) $S + I = X + M$.
(c) $S = I$; $X = M$.
(d) $S - I = X - M$.
(e) $S + I = X - M$.
Answer: D

22. Under the current international monetary system,
(a) each country can choose whether it wants a fixed or a floating exchange rate.
(b) surveillance is conducted by the International Monetary Fund (IMF) over the exchange-rate policies of its members.
(c) there is joint floating by some countries.
(d) All of the above.
Answer: D

23. One reason the Bretton Woods system did not work well was that
(a) floating exchange rates do not work.
(b) speculators were in a no-lose situation in anticipating which countries would devalue their currencies.
(c) fixed exchange rates do not work.
(d) America has too much gold.
(e) most countries are unwilling to suffer the consequences of currency depreciation.
Answer: B

24. The supply of foreign exchange to the United States decreases if
(a) imports of Japanese automobiles increase.
(b) exports of U.S. wheat increase.
(c) imports of German cameras decrease.
(d) exports of U.S. commercial aircraft decrease.
(e) None of the above.
Answer: D
25. Under a floating exchange-rate system, an increase in the American demand for British pounds will
(a) increase the number of pounds that can be purchased with one dollar.
(b) increase the number of dollars that are required to purchase one pound.
(c) decrease the number of dollars that can be purchased with one pound.
(d) raise the price of dollars in terms of pounds.
(e) not affect the number of dollars.
Answer: B

26. A fixed exchange-rate system can automatically eliminate official surpluses or official deficits if
(a) gold is used.
(b) the money supply does not change when there is a surplus or a deficit.
(c) people act unselfishly.
(d) payments surpluses increase the money supply and payments deficits decrease the money supply.
(e) prices in each country adjust.
Answer: D

27. When all of the credit or debit items in the balance of payments are added together,
(a) a surplus or deficit may occur.
(b) merchandise exports must equal merchandise imports.
(c) capital exports must equal capital imports plus the statistical discrepancy.
(d) the total deficit or surplus must be zero.
(e) a capital inflow will occur.
Answer: D

28. If a country has been a net capital importer for only a very short time, it is likely that
(a) imports of goods and services will exceed exports of goods and services.
(b) exports of goods and services will exceed imports of goods and services.
(c) the country’s money supply will be increasing at a faster rate.
(d) the country’s money supply will be increasing at a slower rate.
(e) None of the above.
Answer: A

29. An international gold standard requires all of the following except that
(a) each country set a price for its currency in terms of gold.
(b) each country allow anyone to convert gold into its currency and vice versa.
(c) the domestic money supply be tied to the domestic stock of monetary gold.
(d) gold circulate within each country.
(e) exchange rates reflect relative gold contents.
Answer: D
30. Which of the following correctly defines the concept of purchasing-power parity?
   (a) Managed floating exchange rates.
   (b) A gold standard international monetary system.
   (c) A balance of payment surplus maintained by capital exports.
   (d) The Bretton Woods international monetary system.
   (e) Currency exchange rates that would equalize the price of internationally traded goods.
   Answer: E

31. Critics of the current international monetary system charge that
   (a) it has poorly handled oil deficits.
   (b) the foreign-exchange market is inefficient.
   (c) it may encourage too much inflation.
   (d) it relies too much on the International Monetary Fund (IMF).
   (e) All of the above.
   Answer: C

32. Under a floating exchange rate-system, an increase in capital exports from a country will
   (a) increase capital imports by an equal amount.
   (b) cause the exchange rate to depreciate and, thereby increase the current account surplus.
   (c) cause the exchange rate to appreciate and, thereby increase the current account surplus.
   (d) have no impact on the exchange rate.
   (e) increase the money supply.
   Answer: B

33. With floating exchange rates, an autonomous increase in imports
   (a) increases exports because the currency depreciates.
   (b) decreases exports because the currency appreciates.
   (c) does not increase exports at all.
   (d) increases exports because the currency appreciates.
   (e) does not affect the currency at all.
   Answer: A

34. A country’s balance of payments may go through stages because
   (a) an immature creditor country has a trade deficit.
   (b) a mature creditor country has a trade surplus.
   (c) the trade balance turns from surplus to deficit the longer a country is a net capital exporter.
   (d) trade deficits must balance trade surpluses.
   (e) None of the above.
   Answer: C
35. The floating exchange rate-system finds an equilibrium
   (a) by letting a country’s exchange rate adjust whenever reserves change.
   (b) by letting the money supply rise or fall as the exchange rate rises or falls.
   (c) by letting the exchange rate seek that level at which the quantity of foreign exchange demanded
       equals the foreign exchange supplied.
   (d) by letting the exchange rate float with the interest rate set by a country’s central bank.
   (e) when staffs of economists determine the equilibrium exchange rate on a day-by-day basis.
   Answer: C

36. One reason the international gold standard broke down after World War I is that
   (a) gold became too costly to mine.
   (b) gold became too cheap to prevent inflation.
   (c) the Great Depression made further deflation (due to a trade deficit) undesirable.
   (d) platinum became more valuable than gold.
   (e) Britain had undervalued the pound sterling and France had overvalued the franc.
   Answer: C

37. Supporters of the current international monetary system argue that it
   (a) allows monetary autonomy.
   (b) eases balance-of-payments adjustment.
   (c) recycles oil revenues easily.
   (d) All of the above.
   Answer: D

38. Which of the following is correct? Foreign exchange
   (a) is a term that refers to imports and exports collectively.
   (b) is the market in which the balance of payments is cleared.
   (c) is sometimes called the visible trade balance.
   (d) has increased world inflation.
   (e) refers to a country’s demand for currencies other than its own.
   Answer: E

39. A currency is said to appreciate
   (a) when it can buy more foreign exchange.
   (b) when its demand curve slopes downward.
   (c) when it floats.
   (d) when speculators sell gold.
   (e) when the country uses a fixed exchange rate system.
   Answer: A

40. All of the following would be credit items in the balance of payments except
   (a) merchandise exports.
   (b) capital inflows.
   (c) private gifts to foreigners.
   (d) payments for U.S. services to foreigners.
   (e) All of the above are credit items.
   Answer: C
41. Which of the following is correct? The Bretton Woods system
   (a) was essentially a gold standard with monetary policy dominated by the London financial market.
   (b) was a managed floating exchange rate system.
   (c) was a fixed exchange rate system backed by international currency reserves.
   (d) was a gold standard system based on international gold reserves.
   (e) All of the above.
   Answer: C

42. The role of international capital movements
   (a) is to take wealth from rich countries and to transfer it to poor countries.
   (b) is to direct one country’s saving into investments in another country.
   (c) is to get needed capital to low-interest economies suffering from a capital shortage.
   (d) is to substitute for international labor movements.
   (e) All of the above.
   Answer: B

43. If an English suit costs 200 English pounds and the dollar exchange rate is $1.50 per pound, the suit would cost an American
   (a) $133.33.
   (b) $200.
   (c) $400.
   (d) $300.
   (e) $100.
   Answer: D

44. Suppose England experiences inflation. Purchasing-power parity exists between the currency of England and the United States if
   (a) one U.S. dollar buys one English pound.
   (b) income is the same in England and the United States.
   (c) the price of England’s currency falls to a level at which the price of English imports to the United States are equal before and after English inflation.
   (d) England and the United States have the same supply of money.
   (e) None of the above.
   Answer: C