Don’t forget to download a copy of the Homework Cover Sheet. Mark the location where you handed in your work.

**Homework #6: Chapter 12.** This homework has three parts (A, B, C). Each part will be separately graded.

**Part A, HW #6, Ch #12.**

Go to technical problems, page 330. Do the following problems. Show your work.

1. 
4.

**Part B, HW#6, Ch #12.**

Go to empirical problems, page 331. Do the following problems. Show your work.

1. 
2.

**Part C, HW#6, CH#12.**

MC Quiz, 25 questions, use red score sheet handed out in class or available outside Heady 281 or Heady 67.

We will use the following grading scale.

- A = 20+
- B = 19, 18, 17
- C = 16, 15, 14
- D = 13, 12, 11
- F = < 11

1. The record of international trade in goods and services and international transfer payments is called
   A) the balance of payments
   B) the capital account
   C) the current account
   D) the foreign account
   E) the exchange rate account
2. If a country has a balance-of-payments surplus, we know for sure that
   A) the current account shows a surplus
   B) the capital account shows a surplus
   C) the sum of the current and capital accounts shows a surplus
   D) net exports are positive
   E) all of the above have to be true

3. A country's balance of payments can be affected by changes in
   A) domestic income
   B) foreign income
   C) the real exchange rate
   D) the differential between domestic and foreign interest rates
   E) all of the above

4. The balance of payments measures
   A) the amount of foreign exchange intervention needed from the central banks
   B) exports minus imports
   C) the record of exchange in goods and services
   D) the value of a representative basket of foreign currencies in terms of the dollar
   E) none of the above

5. If the real exchange rate is 1.0, the price level of U.S. goods is 120, and the dollar price of foreign exchange is 0.8, what is the price level of foreign goods?
   A) 75
   B) 80
   C) 100
   D) 120
   E) 150

6. If the U.S. real exchange rate is greater than 1, we can expect that
   A) goods in the U.S., on average, are more expensive than goods abroad
   B) goods abroad, on average, are more expensive than goods in the U.S.
   C) foreigners are less likely to buy more U.S. goods
   D) the exchange rate should increase
   E) domestic prices should decrease

7. If the real exchange rate is equal to 1,
   A) currencies are at purchasing power parity
   B) the relative demand for domestically produced goods will rise
   C) the relative demand for domestically produced goods will fall
   D) foreign investors will try to buy more domestic assets
   E) net exports is equal to zero

8. Which of the following is the equation for the real exchange rate?
   A) \[ R = \frac{P}{P_f} \]
   B) \[ R = \frac{P_f}{P} \]
   C) \[ R = e\left(\frac{P}{P_f}\right) \]
   D) \[ R = e\left(\frac{P_f}{P}\right) \]
   E) \[ R = \frac{e}{(P/P_f)} \]
9. The increase in the real exchange rate shows
   A) the increase in the ratio of domestic to foreign prices
   B) the increase in foreign prices expressed in U.S. dollars relative to prices of goods produced in the U.S.
   C) the decrease in foreign prices expressed in U.S. dollars relative to prices of goods produced in the U.S.
   D) the decrease in competitiveness of U.S. goods
   E) the decrease in the dollar price of foreign exchange

10. If the dollar price of foreign goods increases, we can expect that
    A) U.S. imports and U.S. exports will both increase
    B) U.S. imports will decrease and U.S. exports will increase
    C) U.S. imports will increase and U.S. exports will decrease
    D) U.S. imports will increase and U.S. exports will stay the same
    E) U.S. net exports will decrease

11. Assume the Japanese yen has appreciated relative to the U.S. dollar. Which of the following is true?
    A) each dollar can now buy more yen
    B) each yen can now buy more dollars
    C) each dollar can now buy more Japanese goods
    D) the Japanese central bank is forced to sell dollars
    E) both A) and C)

12. A real depreciation of the domestic currency will
    A) improve the trade balance and increase aggregate demand
    B) improve the trade balance and lower aggregate demand
    C) improve the trade balance but not affect aggregate demand
    D) lower the trade balance and aggregate demand
    E) lower the trade balance and increase aggregate demand

13. If we compare a closed economy to an open economy under a flexible exchange rate system, we can see that fiscal policy is always
    A) more effective because of positive repercussion effects
    B) more effective because the marginal propensity to import is positive
    C) equally effective because domestic fiscal policy has no effect on the trade balance
    D) less effective because part of the increase in domestic income is spent on foreign goods
    E) less effective because expansionary fiscal policy always has to be supplemented by restrictive monetary policy

14. Restrictive monetary policy in the U.S.
    A) raises U.S. interest rates and lowers U.S. GDP
    B) increases the value of the dollar relative to other currencies
    C) increases U.S. net exports
    D) both A) and B)
    E) both A) and C)
15. In which exchange rate system do central banks always stand ready to buy and sell their currency at a predetermined price?
A) a floating exchange rate system
B) a flexible exchange rate system
C) a managed exchange rate system
D) a fixed exchange rate system
E) a dirty floating exchange rate system

16. A fixed exchange rate system is in effect
A) a free market system
B) an open market system
C) a price support system
D) an international transactions system
E) an international transfer system

17. Under fixed exchange rates, when a foreign central bank devalues its currency it
A) lowers the dollar price of its currency
B) raises the dollar price of its currency
C) purchases dollars in the foreign exchange market
D) sells dollars in the foreign exchange market
E) adds a variety of other foreign currencies to its reserves

18. When exchange rates are fixed and capital is perfectly mobile, monetary policy
A) is very effective in changing the level of output
B) is completely ineffective in changing the level of output
C) is effective in changing the level of output but not domestic interest rates
D) can be conducted independently of exchange rate considerations
E) will shift the LM-curve, but the IS-curve will have to shift subsequently since interest rates can't change

19. Under flexible exchange rates
A) monetary policy is ineffective while fiscal policy is very effective in changing the level of output
B) monetary and fiscal policy are both very effective in changing the level of output
C) monetary policy is effective while fiscal policy is ineffective in changing the level of output
D) monetary and fiscal policy are both fairly ineffective in changing the level of output
E) monetary and fiscal policy have to be carefully coordinated if the level of output needs to be changed
20. If capital is perfectly mobile internationally, then
   A) significant differences in interest rates across countries can persist over a long time
   B) one country's interest rates can be substantially higher than the world interest rate over the long run
   C) countries with interest rates much lower than in the rest of the world will experience an outflow of capital
   D) an increase in U.S. interest rates will worsen the U.S. balance of payments since U.S. banks are more willing to lend internationally
   E) all of the above

21. In a flexible exchange rate system with perfect capital mobility, if restrictive fiscal policy is implemented, we will see
   A) a shift of the IS-curve to the left followed by a depreciation of the currency and a subsequent shift of the IS-curve back to its original position
   B) a shift of the IS-curve to the left followed by a depreciation of the currency and a subsequent shift of the LM-curve to the left, leaving the domestic interest rate unchanged
   C) a shift of the IS-curve to the left followed by an appreciation of the currency
   D) a shift of the LM-curve to the left followed by an appreciation of the currency and a subsequent shift of the LM-curve back to its original position
   E) a temporary decrease in the interest rate but a long-term decrease in the level of output

22. In an IS-LM model with flexible exchange rates and perfect capital mobility, a decrease in the income tax rate will
   A) initially stimulate the economy but in the end not change the equilibrium level of output
   B) increase the domestic interest rate but only temporarily
   C) cause a change in the composition of output
   D) cause an inflow of funds that will lead to an appreciation of the domestic currency
   E) all of the above

23. In an IS-LM model with fixed exchange rates and perfect capital mobility, a cut in government spending shifts the IS-curve to the left
   A) without affecting the LM-curve
   B) but then back to the right again because of the resulting increase in net exports
   C) but then the central bank is forced to restrict the money supply, so the LM-curve also shifts to the left
   D) but then the central bank is forced to expand money supply, so the LM-curve shifts to the right
   E) but then a capital inflow from abroad results, forcing the government to reverse its policy
24. In an open economy IS-LM model with perfect capital mobility and flexible exchange rates, restrictive monetary policy causes the LM-curve to shift
   A) to the left with a subsequent shift of the IS-curve to the left due to a currency appreciation
   B) to the right with a subsequent shift of the IS-curve to the right due to a currency appreciation
   C) to the left with a subsequent shift of the IS-curve to the right due to a currency appreciation
   D) first to the left and then back to the right due to a currency appreciation
   E) to the left while the IS-curve remains the same

25. Which of the following targets were specified in the 1991 Maastricht Treaty to create a convergence process to a common European currency for the countries of the European Union?
   A) an inflation rate of 2% or less
   B) a budget deficit of less than 2% of GDP
   C) an income-debt ratio of less than 60%
   D) all of the above
   E) none of the above