

# CHAPTER 14

## BALANCE-OF-PAYMENTS ADJUSTMENTS UNDER FIXED EXCHANGE RATES

### MULTIPLE-CHOICE QUESTIONS

1. 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
  
2. 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
  
3. 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
  
4. 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

5. During the gold standard era, central bankers agreed to react positively to international gold flows so as to *reinforce* the automatic adjustment mechanism. Which of the following best represents the above statement?
  - a. Income-adjustment mechanism
  - b. Price-adjustment mechanism
  - c. Rules of the game
  - d. Discretionary fiscal policy
  
6. 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
  
7. 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
  
8. 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 capital inflow
  - b. Rise in its interest rate and a short-term capital outflow
  - c. Fall in its interest rate and a short-term capital inflow
  - d. Fall in its interest rate and a short-term capital outflow
  
9. 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 capital inflow
  - b. Rise in its interest rate and a short-term capital outflow
  - c. Fall in its interest rate and a short-term capital inflow
  - d. Fall in its interest rate and a short-term capital outflow
  
10. Assume that Canada initially faces payments equilibrium in its merchandise trade account as well as in its capital account. Now suppose that Canadian interest rates *increase* to levels *higher* than those abroad. For Canada, this tends to promote:
  - a. Net capital inflows
  - b. Net capital outflows
  - c. Net merchandise exports
  - d. Net merchandise imports

11. Assume that Canada initially faces payments equilibrium in its merchandise trade account as well as in its capital account. Now suppose that Canadian interest rates *fall* to levels *below* those abroad. For Canada, this tends to promote:
  - a. Net capital inflows
  - b. Net capital outflows
  - c. Net merchandise exports
  - d. Net merchandise imports
  
12. Suppose the United States levies an interest equalization tax, which taxes Americans on dividend and interest income from foreign securities. Such a tax would be intended to:
  - a. Encourage capital movements from the United States to overseas
  - b. Discourage capital movements from the United States to overseas
  - c. Discourage capital movements from overseas to the United States
  - d. None of the above
  
13. Assume that interest rates on comparable securities are identical in the United States and foreign countries. Now suppose that investors anticipate that in the future the U.S. dollar will *appreciate* against foreign currencies. Investment funds would thus be expected 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. Not be affected by the expected dollar appreciation
  
14. 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

On the basis of the following information, answer the next *three* questions. Assume the marginal propensity to consume for U.S. households equals 0.9, and the marginal propensity to import for the United States equals 0.1. Suppose there occurs an *increase* in investment of \$10 billion at each level of income.

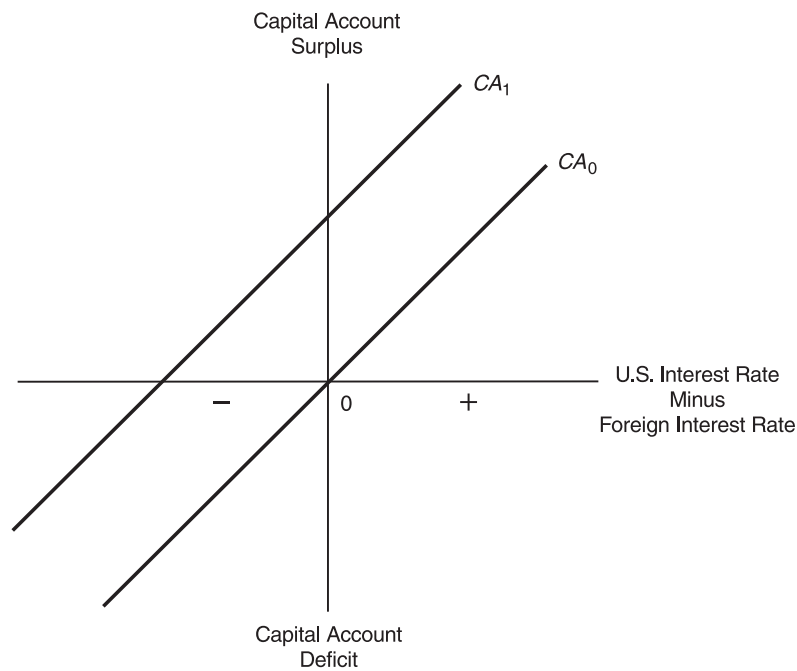
15. The value of the multiplier for the United States equals:
  - a. 2
  - b. 3
  - c. 4
  - d. 5
  
16. The change in the level of U.S. income resulting from the additional investment spending equals:
  - a. \$20 billion
  - b. \$30 billion
  - c. \$40 billion
  - d. \$50 billion

17. The change in the level of U.S. imports resulting from the rise in U.S. income equals:
  - a. \$5 billion
  - b. \$10 billion
  - c. \$15 billion
  - d. \$20 billion
  
18. 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
  
19. 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
  
20. 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):
  - a. Decrease in the money supply
  - b. Increase in the money demand
  - c. Decrease in the money demand
  - d. None of the above
  
21. 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
  
22. 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
  
23. According to the quantity theory of money, a change in the domestic money supply will bring about:
  - a. Inverse and proportionate changes in the price level
  - b. Inverse and less-than-proportionate changes in the price level
  - c. Direct and proportionate changes in the price level
  - d. Direct and less-than-proportionate changes in the price level

24. 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
  
25. The value of the foreign trade multiplier equals the reciprocal of the sum of the marginal propensities to:
  - a. Save plus import
  - b. Import plus invest
  - c. Consume plus export
  - d. Save plus import
  
26. 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
  
27. 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. A decrease in the money supply
  - b. An increase in the money supply
  - c. A decrease in the money demand
  - d. None of the above
  
28. 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
  
29. 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

30. Suppose that rising U.S. income leads to higher sales and profits in the United States. This would likely result in:
- Increasing portfolio investment into the United States
  - Decreasing portfolio investment into the United States
  - Increasing direct investment into the United States
  - Decreasing direct investment into the United States
31. Refer to Figure 14.1. Upward movements along U.S. capital-account schedule  $CA_0$  would be caused by:
- U.S. interest rates rising relative to foreign interest rates
  - U.S. interest rates falling relative to foreign interest rates
  - Taxes placed on income earned by U.S. residents from their foreign investments
  - Taxes placed on income earned by foreign residents from their U.S. investments

**Figure 14.1.** *U.S. Capital Account*



32. Refer to Figure 14.1. Downward movements along U.S. capital-account schedule  $CA_0$  would be caused by:
- U.S. interest rates rising relative to foreign interest rates
  - U.S. interest rates falling relative to foreign interest rates
  - Taxes placed on income earned by U.S. residents from their foreign investments
  - Taxes placed on income earned by foreign residents from their U.S. investments

33. Refer to Figure 14.1. The U.S. capital-account schedule would shift upward from  $CA_0$  to  $CA_1$  if:
- U.S. interest rates exceeded foreign interest rates
  - Foreign interest rates exceeded U.S. interest rates
  - Taxes were placed on income earned by U.S. residents from their foreign investments
  - Taxes were placed on income earned by foreign residents from their U.S. investments
34. Refer to Figure 14.1. The U.S. capital-account schedule would shift upward from  $CA_0$  to  $CA_1$  if:
- U.S. residents receive subsidies to invest in foreign nations
  - U.S. interest rates rise relative to foreign interest rates
  - Taxes are reduced on income earned by U.S. residents from their foreign investments
  - Expected profits decline on U.S. investments in foreign manufacturing
35. Refer to Figure 14.1. The U.S. capital-account schedule would shift upward from  $CA_0$  to  $CA_1$  if:
- U.S. political stability improves relative to foreign political stability
  - U.S. interest rates rise relative to foreign interest rates
  - Taxes are placed on income earned by U.S. residents from foreign investments
  - Restrictions are imposed on international loans granted by foreign banks
36. Refer to Figure 14.1. U.S. capital-account schedule  $CA_0$  would shift upwards, or downwards, for all of the following reasons *except*:
- U.S. residents being taxed on income earned from foreign investments
  - U.S. banks being restricted on loans that can be made abroad
  - U.S. political stability changing relative to foreign political stability
  - U.S. interest rates changing relative to foreign interest rates

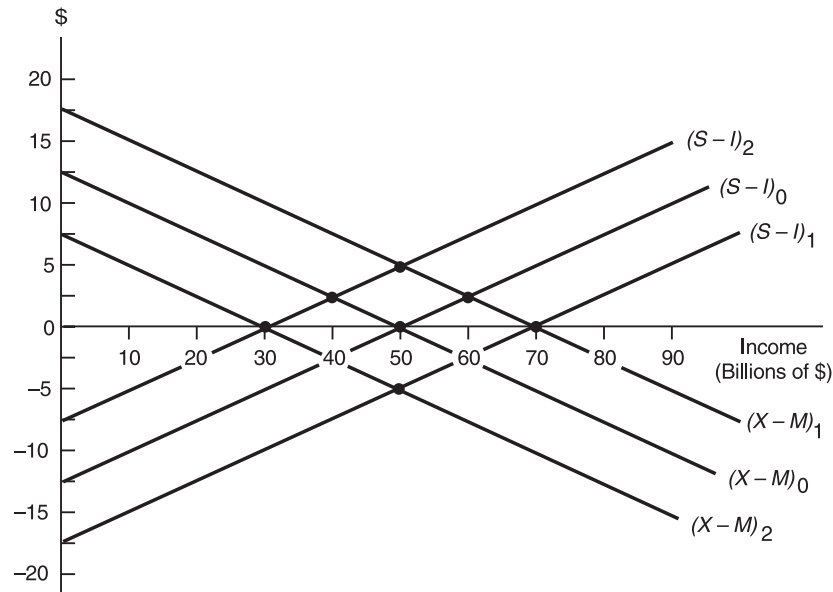
Use the data in Table 14.1 to answer Questions 37 through 42.

**Table 14.1.** *Canada's Saving, Investment, Import, and Export Functions*  
(in billions of dollars)  
*Under a System of Fixed Exchange Rates*

Export Function	$X = 3000$
Investment Function	$I = 1000$
Saving Function	$S = -1000 + 0.2Y$
Import Function	$M = 500 + 0.25Y$

37. Refer to Table 14.1. If Canada's income rises by \$200 billion, saving would rise by:
- \$10 billion
  - \$20 billion
  - \$30 billion
  - \$40 billion

38. Refer to Table 14.1. If Canada's income rises by \$200 billion, imports would rise by:
- \$50 billion
  - \$75 billion
  - \$100 billion
  - \$125 billion
39. Refer to Table 14.1. Canada's foreign trade multiplier equals:
- 1.75
  - 2.05
  - 2.22
  - 2.64
40. Refer to Table 14.1. Canada's equilibrium level of income is:
- \$8,000 billion
  - \$9,000 billion
  - \$10,000 billion
  - \$11,000 billion
41. Refer to Table 14.1. If improved business optimism leads to increases in Canada's planned investment spending from \$1,000 billion to \$1,200 billion, Canada's equilibrium income rises by approximately:
- \$444 billion
  - \$555 billion
  - \$666 billion
  - \$777 billion
42. Refer to Table 14.1. If weak economic conditions abroad result in Canada's exports falling from \$3,000 billion to \$2,500 billion, Canada's equilibrium income falls by approximately:
- \$888 billion
  - \$990 billion
  - \$1,110 billion
  - \$1,220 billion
43. Refer to Figure 14.2. The slope of the  $(X - M)$  schedule and  $(S - I)$  schedule indicates that Australia's foreign trade multiplier is:
- 0.5
  - 1.0
  - 1.5
  - 2.0
44. Refer to Figure 14.2. Starting at equilibrium income \$50 billion, where  $(S - I)_0$  intersects  $(X - M)_0$ , suppose that improving economic conditions abroad lead to an autonomous increase in Australian exports of \$5 billion. Australian income thus \_\_\_\_\_, which leads to Australia's trade account moving to a \_\_\_\_\_.
- Rises to \$60 billion, surplus of \$2.5 billion
  - Rises to \$60 billion, surplus of \$5 billion
  - Falls to \$40 billion, deficit of \$2.5 billion
  - Falls to \$40 billion, deficit of \$5 billion

**Figure 14.2.** Australian Economy Under a Fixed Exchange Rate System

45. Refer to Figure 14.2. Starting at equilibrium income \$50 billion, where  $(S - I)_0$  intersects  $(X - M)_0$ , suppose that worsening economic conditions abroad lead to an autonomous decrease in Australian exports of \$5 billion. Australian income thus \_\_\_\_\_, which leads to Australia's trade account moving to a \_\_\_\_\_.
- Rises to \$60 billion, surplus of \$2.5 billion
  - Rises to \$60 billion, surplus of \$5 billion
  - Falls to \$40 billion, deficit of \$2.5 billion
  - Falls to \$40 billion, deficit of \$5 billion
46. Refer to Figure 14.2. Starting at equilibrium income \$50 billion, where  $(S - I)_0$  intersects  $(X - M)_0$ , suppose that improving profit expectations lead to an autonomous increase in Australian investment of \$5 billion. Australian income thus \_\_\_\_\_, which leads to Australia's trade account moving to a \_\_\_\_\_.
- Rises to \$60 billion, deficit of \$2.5 billion
  - Rises to \$60 billion, deficit of \$5 billion
  - Falls to \$40 billion, surplus of \$2.5 billion
  - Falls to \$40 billion, surplus of \$5 billion
47. Refer to Figure 14.2. Starting at equilibrium income \$50 billion, where  $(S - I)_0$  intersects  $(X - M)_0$ , suppose that worsening profit expectations lead to an autonomous decrease in Australian investment of \$5 billion. Australian income thus \_\_\_\_\_, which leads to Australia's trade account moving to a \_\_\_\_\_.
- Rises to \$60 billion, deficit of \$2.5 billion
  - Rises to \$60 billion, deficit of \$5 billion
  - Falls to \$40 billion, surplus of \$2.5 billion
  - Falls to \$40 billion, surplus of \$5 billion

48. Refer to Figure 14.2. Starting at equilibrium income \$50 billion, where  $(S - I)_0$  intersects  $(X - M)_0$ , suppose that increased thriftiness leads to an autonomous increase in Australian saving of \$5 billion. Australian income thus \_\_\_\_\_, which leads to Australia's trade account moving to a \_\_\_\_\_.
- Rises to \$60 billion, deficit of \$2.5 billion
  - Rises to \$60 billion, deficit of \$5 billion
  - Falls to \$40 billion, surplus of \$2.5 billion
  - Falls to \$40 billion, surplus of \$5 billion
49. Refer to Figure 14.2. Starting at equilibrium income \$50 billion, where  $(S - I)_0$  intersects  $(X - M)_0$ , suppose that dwindling thriftiness leads to an autonomous decrease in Australian saving to \$5 billion. Australian income thus \_\_\_\_\_, which leads to Australia's trade account moving to a \_\_\_\_\_.
- Rises to \$60 billion, deficit of \$2.5 billion
  - Rises to \$60 billion, deficit of \$5 billion
  - Falls to \$40 billion, surplus of \$2.5 billion
  - Falls to \$40 billion, surplus of \$5 billion
50. Refer to Figure 14.2. Starting at equilibrium income \$50 billion, where  $(S - I)_0$  intersects  $(X - M)_0$ , suppose that changing preferences lead to an autonomous increase in Australian imports of \$5 billion. Australian income thus \_\_\_\_\_, which leads to Australia's trade account moving to a \_\_\_\_\_.
- Rises to \$60 billion, surplus of \$2.5 billion
  - Rises to \$60 billion, surplus of \$5 billion
  - Falls to \$40 billion, deficit of \$2.5 billion
  - Falls to \$40 billion, deficit of \$5 billion
51. Refer to Figure 14.2. Starting at equilibrium income \$50 billion, where  $(S - I)_0$  intersects  $(X - M)_0$ , suppose that changing preferences lead to an autonomous decrease in Australian imports of \$5 billion. Australian income thus \_\_\_\_\_, which leads to Australia's trade account moving to a \_\_\_\_\_.
- Rises to \$60 billion, surplus of \$2.5 billion
  - Rises to \$60 billion, surplus of \$5 billion
  - Falls to \$40 billion, deficit of \$2.5 billion
  - Falls to \$40 billion, deficit of \$5 billion

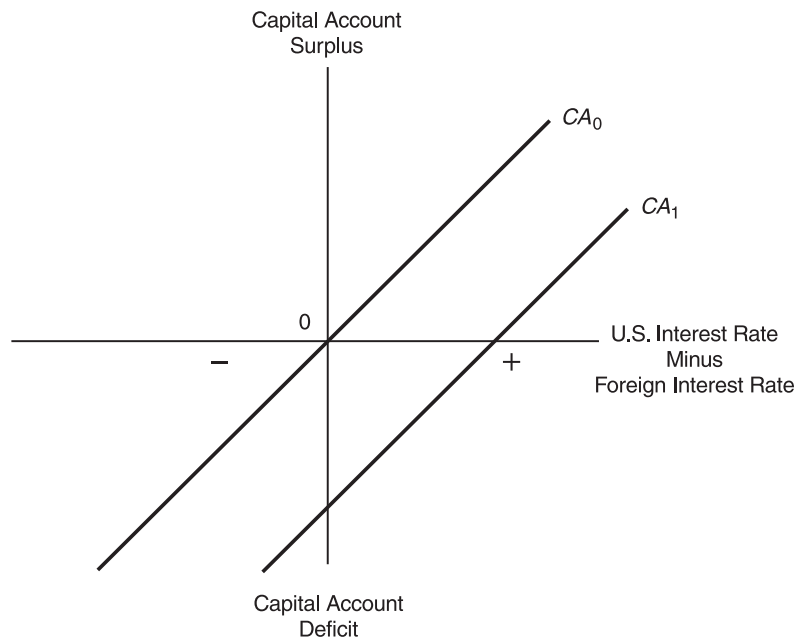
### TRUE-FALSE QUESTIONS

- T F 1. Under a fixed exchange rate system, adjustment mechanisms work for the automatic return to current-account balance after the initial balance has been disrupted.
- T F 2. When a country's current account moves into disequilibrium, automatic adjustments in tariffs and quotas occur which move the current account back into equilibrium.
- T F 3. Prices, interest rates, and income are the automatic adjustment variables that help restore current-account equilibrium under a system of fixed exchange rates.

- 
- T F 4. That the balance of payments could be adjusted by prices and interest rates, under a fixed exchange rate system, originated with Keynesian theory during the 1930s.
- T F 5. David Hume's price-adjustment mechanism supported the mercantilist view that a nation could maintain a trade surplus indefinitely.
- T F 6. Under the price-adjustment mechanism, a government's efforts to maintain a current-account surplus is self defeating over the long run because a nation's current account automatically moves toward equilibrium.
- T F 7. Under the gold standard of the 1800s, exchange rates were allowed to float freely in the currency markets.
- T F 8. Under the gold standard, each participating nation defined the mint price of gold in terms of its national currency and was prepared to buy and sell gold at that price.
- T F 9. 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.
- T F 10. The essence of the classical price-adjustment mechanism is embodied in the quantity theory of money.
- T F 11. According to the equation of exchange, the total expenditures on final goods equals the monetary value of the final goods sold.
- T F 12. Regarding the equation of exchange, the classical economists assumed that final output was below its maximum level while the velocity of money was volatile.
- T F 13. According to the quantity theory of money, a change in the money supply will induce an inverse and less-than-proportionate change in the price level.
- T F 14. Under the price-adjustment mechanism, a trade-surplus nation would realize gold inflows, an increase in its money supply, and a loss of international competitiveness.
- T F 15. The price-adjustment mechanism's relevance to the real world has been questioned on the grounds that national output is generally not at the full-employment level and that the velocity of money is not always constant.
- T F 16. According to the price-adjustment mechanism, trade deficits can occur only in the long run rather than in the short run.
- T F 17. Under the price-adjustment mechanism, trade-deficit nations realize price inflation and a loss of competitiveness while trade surplus nations realize price deflation and an improvement in competitiveness.

- T F 18. Under the classical gold standard, adjustments in domestic prices and short-term interest rates automatically promoted balance-of-payments equilibrium over the long run.
- T F 19. Under the classical gold standard, a trade surplus nation would realize gold inflows, an increase in its money supply, rising interest rates, and net investment inflows.
- T F 20. The gold standard's "rules of the game" required central bankers in a surplus country to initiate contractionary monetary policies which lead to higher interest rates and net investment inflows.
- T F 21. The gold standard's "rules of the game" required central bankers in a trade deficit nation to expand the money supply, leading to falling interest rates and net investment outflows.
- T F 22. The "rules of the game" served to reinforce and speed up the interest-rate-adjustment mechanism under a system of fixed exchange rates.
- T F 23. Refer to Figure 14.3. As U.S. interest rates rise relative to foreign interest rates, the U.S. slides upward along schedule  $CA_0$ , thus moving towards capital-account surplus.

**Figure 14.3.** *U.S. Capital Account Under a Fixed Exchange Rate System*

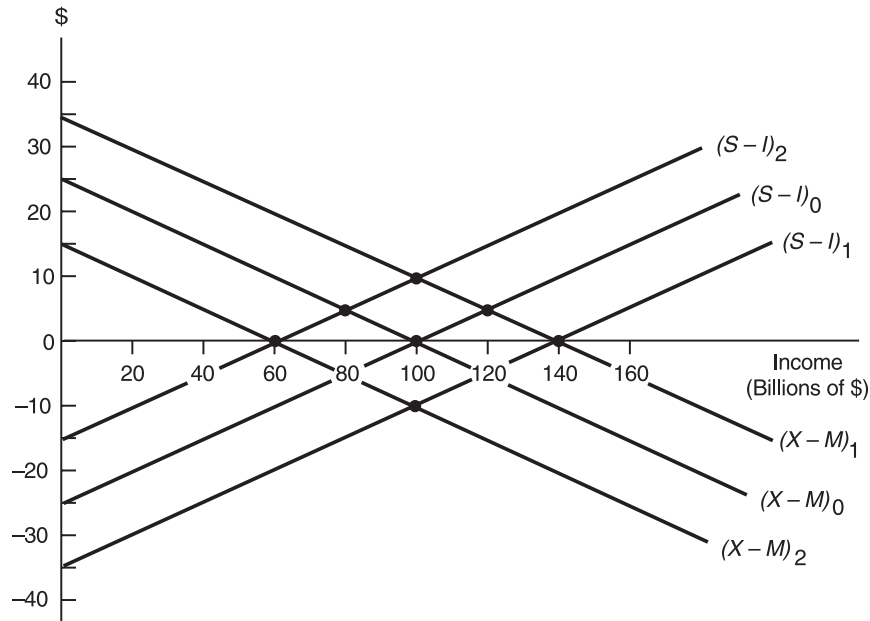


- T F 24. Refer to Figure 14.3. Decreases in U.S. interest rates relative to foreign interest rates would shift U.S. capital-account schedule  $CA_0$  downward toward  $CA_1$ , resulting in net capital outflows from the United States.

- T F 25. Refer to Figure 14.3. Falling investment profitability in the United States, relative to investment profitability abroad, would shift the U.S. capital-account schedule downward from  $CA_0$  to  $CA_1$ , resulting in net capital outflows from the United States.
- T F 26. Refer to Figure 14.3. As the U.S. government decreases taxes on income earned by U.S. residents from foreign investments, the U.S. capital-account schedule shifts downward from  $CA_0$  to  $CA_1$  and the United States realizes net capital outflows.
- T F 27. Refer to Figure 14.3. If the political and economic stability of foreign countries worsens relative to that of the United States, the U.S. capital-account schedule would shift downward from  $CA_0$  to  $CA_1$ , resulting in net capital outflows from the United States.
- T F 28. According to the Keynesian income-adjustment mechanism, income differentials among nations guarantee current-account equilibrium in a world of fixed exchange rates.
- T F 29. Keynesian theory asserts that, under a system of fixed exchange rates, the influence of income changes in surplus and deficit countries will automatically promote current-account equilibrium.
- T F 30. The Keynesian income-adjustment mechanism contends that a trade-surplus nation tends to realize falling income and falling imports, thus accentuating the trade surplus.
- T F 31. The foreign-trade multiplier equals the sum of the marginal propensity to import and the marginal propensity to save.
- T F 32. If the marginal propensity to save equals 0.2 and the marginal propensity to import equals 0.3, the foreign-trade multiplier equal 2.0.
- T F 33. For an open economy subject to international trade, equilibrium income occurs where saving plus investment equals imports plus exports.
- T F 34. If the marginal propensity to save equals 0.1 and the marginal propensity to import equals 0.3, an autonomous increase in exports of \$1,000 would expand domestic income by \$2,500 which leads to an increase in imports of \$750.
- T F 35. If the marginal propensity to save equals 0.2 and the marginal propensity to import equals 0.3, an autonomous decrease in investment spending of \$1 million leads to a \$2 million decrease in domestic income and a \$600,000 decrease in imports.
- T F 36. For the income adjustment mechanism to reverse a trade deficit, economic policymakers must be willing to permit domestic income to increase which leads to rising imports.
- T F 37. Reliance on an automatic adjustment process tends to be unacceptable in trade-deficit nations since it requires them to accept price deflation and/or falling income as a cost of reducing imports.

- T F 38. An “automatic” adjustment mechanism would require a trade-surplus nation to accept price deflation and/or falling income as the cost of increasing imports.
- T F 39. Refer to Figure 14.4. Canada’s marginal propensity to save equals 0.25 and marginal propensity to import equal 0.5.

**Figure 14.4.** Canadian Economy Under a Fixed Exchange Rate System



- T F 40. Refer to Figure 14.4. Canada’s foreign-trade multiplier equals 2.0.
- T F 41. Refer to Figure 14.4. Starting at equilibrium income \$100 billion, where  $(S - I)_0$  intersects  $(X - M)_0$ , an autonomous decrease in Canadian imports of \$10 billion leads to a \$20 billion decrease in income and a trade deficit of \$5 billion.
- T F 42. Refer to Figure 14.4. Starting at equilibrium income \$100 billion, where  $(S - I)_0$  intersects  $(X - M)_0$ , an autonomous increase in Canadian investment of \$10 billion leads to a \$20 billion increase in income and no change in the country’s trade account.
- T F 43. Refer to Figure 14.4. Starting at equilibrium income \$100 billion, where  $(S - I)_0$  intersects  $(X - M)_0$ , an autonomous decrease in saving of \$10 billion leads to a \$20 billion increase in income and a trade deficit of \$5 billion.
- T F 44. Refer to Figure 14.4. Starting at equilibrium income \$100 billion, where  $(S - I)_0$  intersects  $(X - M)_0$ , an autonomous decrease in Canadian exports of \$10 billion leads to a \$20 decrease in income and a trade deficit of \$5 billion.

- T F 45. According to the monetary approach, balance-of-payments disequilibriums are the result of imbalances in a country's money supply and money demand.
- T F 46. The monetary approach contends that, under a fixed exchange rate system, an excess supply of money leads to a trade surplus.
- T F 47. The monetary approach contends that, under a fixed exchange rate system, an excess demand for money leads to a trade deficit.
- T F 48. The monetary approach contends that, under a fixed exchange rate system, policies that increase the supply of money relative to the demand for money lead to a trade surplus.

## ANSWERS

### Answers to Multiple-Choice Questions

- |              |              |              |              |              |
|--------------|--------------|--------------|--------------|--------------|
| 1. <b>d</b>  | 12. <b>b</b> | 23. <b>c</b> | 34. <b>d</b> | 45. <b>c</b> |
| 2. <b>c</b>  | 13. <b>b</b> | 24. <b>d</b> | 35. <b>a</b> | 46. <b>a</b> |
| 3. <b>a</b>  | 14. <b>c</b> | 25. <b>a</b> | 36. <b>d</b> | 47. <b>c</b> |
| 4. <b>d</b>  | 15. <b>d</b> | 26. <b>a</b> | 37. <b>d</b> | 48. <b>c</b> |
| 5. <b>c</b>  | 16. <b>d</b> | 27. <b>a</b> | 38. <b>a</b> | 49. <b>a</b> |
| 6. <b>a</b>  | 17. <b>a</b> | 28. <b>a</b> | 39. <b>c</b> | 50. <b>c</b> |
| 7. <b>b</b>  | 18. <b>c</b> | 29. <b>a</b> | 40. <b>c</b> | 51. <b>a</b> |
| 8. <b>d</b>  | 19. <b>d</b> | 30. <b>c</b> | 41. <b>a</b> |              |
| 9. <b>a</b>  | 20. <b>c</b> | 31. <b>a</b> | 42. <b>c</b> |              |
| 10. <b>a</b> | 21. <b>c</b> | 32. <b>b</b> | 43. <b>d</b> |              |
| 11. <b>b</b> | 22. <b>d</b> | 33. <b>c</b> | 44. <b>a</b> |              |

### Answers to True-False Questions

- |              |              |              |              |              |
|--------------|--------------|--------------|--------------|--------------|
| 1. <b>T</b>  | 11. <b>T</b> | 21. <b>F</b> | 31. <b>F</b> | 41. <b>F</b> |
| 2. <b>F</b>  | 12. <b>F</b> | 22. <b>T</b> | 32. <b>T</b> | 42. <b>F</b> |
| 3. <b>T</b>  | 13. <b>F</b> | 23. <b>T</b> | 33. <b>F</b> | 43. <b>T</b> |
| 4. <b>F</b>  | 14. <b>T</b> | 24. <b>F</b> | 34. <b>T</b> | 44. <b>T</b> |
| 5. <b>F</b>  | 15. <b>T</b> | 25. <b>T</b> | 35. <b>T</b> | 45. <b>T</b> |
| 6. <b>T</b>  | 16. <b>F</b> | 26. <b>T</b> | 36. <b>F</b> | 46. <b>F</b> |
| 7. <b>F</b>  | 17. <b>F</b> | 27. <b>F</b> | 37. <b>T</b> | 47. <b>F</b> |
| 8. <b>T</b>  | 18. <b>T</b> | 28. <b>F</b> | 38. <b>F</b> | 48. <b>F</b> |
| 9. <b>F</b>  | 19. <b>F</b> | 29. <b>T</b> | 39. <b>F</b> |              |
| 10. <b>T</b> | 20. <b>F</b> | 30. <b>F</b> | 40. <b>T</b> |              |