International Macroeconomics 5th edition Feenstra Test Bank

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Name:_____ Class:_____ Date:_____

Chapter 01

1. International macroeconomics studies:
   a. decisions of individual households in other countries.
   b. decisions by governments in other countries.
   c. the interrelationship of large-scale economic issues across countries.
   d. the interrelationship of politics and economics within a country.

ANSWER: c

2. International macroeconomics focuses on:
   a. isolated nations.
   b. economy-wide variables such as interest rates, income, prices, and wealth.
   c. city-level economic problems.
   d. market-specific variables such as the price of orange juice.

ANSWER: b

3. Key elements of the international macroeconomy are:
   a. political alliances, capital accumulation, and monopoly power.
   b. many currencies, financial integration, and economic policy choices made in context.
   c. competition, efficiency, and openness.
   d. waste and overuse of natural resources, disregard for the environment, and unfair competition.

ANSWER: b

4. It is _____ to assume that all goods are priced in a common currency in international markets.
   a. correct in every case
   b. dangerous
   c. incorrect in every case
   d. unrealistic

ANSWER: d

5. Understanding how a nation's economy works requires a complete understanding of the:
   a. political system.
   b. level of imports and exports.
   c. exchange rate with other currencies.
   d. tax system.

ANSWER: c

6. What is an exchange rate?

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a. It is the percentage rate of interest charged by international banks to exchange currency.
b. It is the fees banks charge their best customers to exchange currency.
c. It is the price of one nation's currency measured in units of another nation's currency.
d. It is the lending rate for international credit.

ANSWER: c

7. Which of the following would be an exchange rate?
a. One car trades for 1,000 books.
b. One dollar trades for two candy bars.
c. One dollar trades for four quarters.
d. One dollar trades for three pesos.

ANSWER: d

8. Suppose one dollar can purchase eight pesos. This is an example of:
a. an international price.
b. the price of a dollar in terms of pesos.
c. the price of a peso in terms of dollars.
d. the price of goods denominated in dollars.

ANSWER: c

9. Exchange rate behavior is:
a. unimportant in determining income, prices, and flows of goods and services.
b. very important in determining income, prices, and flows of goods and services.
c. very predictable, steady, and not of interest to policymakers.
d. not subject to market forces, but is determined by international agreements.

ANSWER: b

10. Changes in a nation's exchange rates have an impact on:
a. prices of equities but not domestic bonds.
b. relative prices of home and foreign goods.
c. prices of nontradable services.
d. prices of international bonds but not equities.

ANSWER: b

11. Compared with 100 years ago, the number of currencies exchanged today is:
a. dozens fewer.
b. insignificant.
c. many times more.

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d. the same.

ANSWER: c

12. Exchange rates exhibit:
    a. steady behavior across the board.
    b. erratic behavior across the board.
    c. very different behavior, depending on whether the rates are fixed or floating.
    d. variable behavior (sometimes steady and other times erratic), depending on the business cycle.

ANSWER: c

13. A floating exchange rate regime can often lead to:
    a. higher domestic investment.
    b. faster economic growth.
    c. higher inflation.
    d. less stable international trade in goods and services.

ANSWER: d

14. In general, economists divide the world into two types of exchange rate systems:
    a. long run and short run.
    b. fixed and floating.
    c. liberal and conservative.
    d. speculative and risk averse.

ANSWER: b

15. Which best describes the dollar–yuan exchange rate over time?
    a. volatile
    b. steady
    c. gradually rising
    d. gradually declining

ANSWER: b

16. The exchange rate between the U.S. dollar and the Chinese yuan:
    a. resulted in a rise in Chinese buying power.
    b. declined 15% between 2005 and the financial crisis in 2008.
    c. has created a situation in which China is able to get cheap products from the United States.
    d. has been unchanged since July 2005.

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ANSWER: b

17. In June of 2010, the Chinese government:
    a. cracked down on illegal currency trading.
    b. reduced the value of the yuan in terms of the U.S. dollar.
    c. allowed a gradual appreciation in the value of the yuan in terms of the U.S. dollar.
    d. allowed the yuan to fluctuate freely according to the market.

ANSWER: c

18. When an exchange rate is said to be fixed, it:
    a. does not vary at all.
    b. can vary a lot.
    c. changes every day.
    d. is volatile.

ANSWER: a

19. An exchange rate that does not vary with domestic or international economic conditions can be best described as:
    a. fixed.
    b. floating.
    c. undervalued.
    d. correctly valued.

ANSWER: a

20. Compared with the dollar–yuan exchange rate, the dollar–euro exchange rate is best described as:
    a. volatile.
    b. steady.
    c. gradually falling.
    d. gradually rising.

ANSWER: a

21. Compared with the U.S. dollar–euro exchange rate, the U.S. dollar–yuan exchange rate has exhibited:
    a. extreme fluctuation.
    b. much less fluctuation.
    c. a constant value.
    d. complete control by the World Bank.

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ANSWER: b

22. Compared with the U.S. dollar–yuan exchange rate, the average daily fluctuation in the U.S. dollar–euro exchange rate is:
    a. 5 or 6 times as large.
    b. about the same.
    c. somewhat smaller.
    d. 5 or 6 times less.

ANSWER: a

23. Which one of the following reasons does NOT explain why exchange rates are important?
    a. They affect the affordability of imports.
    b. They make exports either more or less expensive for foreign buyers.
    c. They affect the value of foreign assets and their returns.
    d. They affect the profits of all domestic producers.

ANSWER: d

24. A good's relative price indicates its:
    a. value only in its own nation.
    b. value compared with the same good sold in another nation, expressed in a common currency.
    c. exchange value only.
    d. net value after taxes and depreciation.

ANSWER: b

25. If a country’s exchange rate changes, it can expect:
    a. the price of domestic equities to change but not domestic bonds.
    b. a change in the relative prices of home and foreign goods.
    c. a change in the prices of nontradable services.
    d. a change in the prices of international bonds but not equities.

ANSWER: b

26. In the mid-2000s, a Swiss cheese maker blamed its decline in U.S. sales on:
    a. the fall of the euro in terms of the Swiss franc.
    b. the rise of the euro in terms of the Swiss franc.
    c. German tariffs that made the cheese more expensive.
    d. the Euro area recession.

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ANSWER: b

27. When the exchange value of the euro rises in terms of the U.S. dollar, U.S. residents find that European imports are:
    a. cheaper.
    b. more expensive.
    c. oversupplied to the United States.
    d. more heavily taxed by the U.S. government.

ANSWER: b

28. A rise in the exchange rate cannot:
    a. affect the price of a haircut.
    b. increase unemployment.
    c. improve national economic output.
    d. reduce poverty.

ANSWER: a

29. European residents who hold U.S. dollar assets experience a _____ in their value when the dollar exchanges for fewer units of foreign currency.
    a. rise
    b. decline
    c. stagnation
    d. rise in instability

ANSWER: b

30. Under a floating exchange rate regime, U.S. residents who hold European assets benefit when the dollar _____ in value against the euro.
    a. declines
    b. rises
    c. does not change
    d. becomes more stable

ANSWER: a

31. If in January 2007, $1 = 110 yen, and in July 2007, $1 = 90 yen, then a Harley Davidson motorcycle that cost $8,000 in January would cost _____ in Japan in July.
    a. 180,000 yen
    b. 880,000 yen
    c. 720,000 yen

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d. 890,000 yen

ANSWER: c

32. If in January 2019, $1 = 110 yen, and in July 2019, $1 = 90 yen, then a Honda motorcycle that cost 880,000 yen in January would cost _____ in the United States in July.

a. $9,778
b. $8,000
c. $7,220
d. $8,880

ANSWER: a

33. If in January 2019, 0.009 yen = $1, and in July 2019, 0.011 yen = $1, then the dollar:

a. has increased in value (appreciated) against the yen.
b. has decreased in value (depreciated) against the yen.
c. has not changed its value against the yen.
d. will be able to purchase more yen-denominated goods.

ANSWER: b

34. Assume that in 2006 the dollar–euro exchange rate was 1 and in 2007 it was 0.75. If you have $100 million in assets in Germany in 2006, then in 2007 your assets in Germany are:

a. lower by 75 million euro.
b. higher by 75 million euro.
c. worth $133.33 million.
d. worth less than in 2006.

ANSWER: c

35. Assume that in 2018 the dollar–euro exchange rate was 1.05 and in 2019 it was 1.35. If you invested $100 million in assets in Germany in 2018, then in 2019 your assets in Germany are:

a. lower by $28.57 million.
b. higher by $28.57 million.
c. higher by 95.24 million euros.
d. lower by 95.24.million euros.

ANSWER: b

36. Exchange rate crises:

a. are extremely rare.
b. are related to political crises.
c. typically occur in every nation several times each year.

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d. are fairly common.

ANSWER: d

37. An exchange rate crisis can be precipitated by:
a. government default on debts.
b. a sudden domestic financial crisis.
c. loss of confidence in the domestic economy.
d. all of the above.

ANSWER: d

38. Among the following countries, which one has experienced a severe drop in its currency during the last 15 years?
a. New Zealand
b. Zimbabwe
c. Japan
d. Canada

ANSWER: b

39. Argentina's currency crisis, which began in 2002, is blamed for:
a. the lack of literacy and moral corruption.
b. extreme poverty, high unemployment, and social unrest.
c. disturbing the international trade balance.
d. its subsequent high debts.

ANSWER: b

40. In the 21-year period from 1997 to 2018, there were ____ instances of exchange rate crises worldwide.
a. 3
b. 10
c. 16
d. 37

ANSWER: d

41. Which of the following did NOT have an exchange rate crisis after 1990?
a. China
b. Korea
c. Argentina
d. Russia

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ANSWER: a

42. A severe drop in the value of a nation's currency usually results in:
    a. high inflation.
    b. low unemployment.
    c. enhanced ability to pay foreign debts.
    d. rising imports.

ANSWER: a

43. A sharp rise in the value of a nation's currency usually results in:
    a. high inflation.
    b. increased exports.
    c. increased imports.
    d. reduced ability to pay foreign debts.

ANSWER: c

44. Compared with earlier decades, the prevalence of exchange rate crises during the turn of the century (1997–2002) was:
    a. much less severe than in the 1970s with its high inflation and high unemployment.
    b. much more severe in rapidly developing economies such as in South America and East Asia.
    c. very typical of modern economic history, indicating a need for international cooperation.
    d. much reduced as a result of the swift and effective response by the International Monetary Fund.

ANSWER: b

45. The fallout from an international currency crisis episode:
    a. has major and lasting effects on trading partners, financial relationships, and financial and political institutions.
    b. usually has a pattern of brief turmoil followed by periods of relative stability.
    c. is instrumental in getting needed debt relief for poor nations.
    d. is seen in permanent changes in the ways nations handle their international transactions.

ANSWER: a

46. Nations undergoing currency and financial crises often experience:
    a. rising currency values.
    b. falling population.
    c. government financial problems.
    d. increasing GDP.

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ANSWER: c

47. In Argentina, when the exchange rate was floated in 2002, all of the following took place, EXCEPT a sharp:
    a. decline in the exchange rate of the peso.
    b. increase in the level of poverty.
    c. increase in inflation.
    d. decline in unemployment rates.

ANSWER: d

48. Following its 2001 currency crisis, Argentina's unemployment:
    a. fell back to the pre-2001 level.
    b. was lower than during the crisis but higher than before.
    c. was at an all-time high.
    d. was unresponsive to the crisis.

ANSWER: b

49. Globalization of financial markets provides benefits to nations but also carries the risk to international stability due to:
    a. unmanageable debt and subsequent defaults.
    b. political infighting regarding whose currency will be the world leader.
    c. military conflict over control of vital assets.
    d. accumulation of wealth.

ANSWER: a

50. Which of the following are financial instruments?
    a. real estate properties
    b. grocery store loyalty cards
    c. retail store inventories
    d. savings accounts, credit cards, and mortgages

ANSWER: d

51. A nation's current account is:
    a. its current budget deficit.
    b. the previous year's budget deficit.
    c. a record of a nation's income, expenditure, deficit, and surplus during a particular period.
    d. the difference between its total wealth and its total debt.

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ANSWER: c

52. Whenever gross national income is less than gross national expenditure for some time, a nation will experience a(n):
    a. deficit in its current account.
    b. surplus in its current account.
    c. increase in GDP, since firms' sales will rise.
    d. rise in national wealth.

ANSWER: a

53. In 2009, the area with the largest trade deficit was:
    a. China.
    b. the Eurozone.
    c. the United States.
    d. Japan.

ANSWER: c

54. Which of the following situations would NOT be compatible with the others?
    a. a deficit in the current account
    b. expenditure being greater than income (production) in a nation
    c. a rise in national wealth
    d. new borrowing from the rest of the world

ANSWER: c

55. The definition of total external net wealth is:
    a. the value of buildings, bank deposits, and monetary gold.
    b. the value of a nation's foreign assets minus the value of a nation's foreign liabilities.
    c. the value of stocks sold daily on international exchanges.
    d. minerals and oil reserves owned by a nation but located in another nation.

ANSWER: b

56. External wealth can increase by all of the following, EXCEPT:
    a. increases in the value of international assets (capital gains).
    b. decreases in the value of liabilities to international entities.
    c. borrowing from international entities.
    d. lending to international entities.

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ANSWER: c

57. If a nation is a net creditor internationally, it means that:
    a. residents of the nation have more foreign assets than foreign liabilities.
    b. the nation is running low on international assets.
    c. residents of the nation have more foreign liabilities than foreign assets.
    d. the nation's government has extended credit to other nations' governments.

ANSWER: a

58. A nation's net creditor position indicates that it:
    a. has collected more in taxes than its government has spent.
    b. owes money to other foreign and international government agencies.
    c. has positive net external wealth.
    d. has negative net external wealth.

ANSWER: c

59. A country's position as a debtor nation indicates that it:
    a. has collected less in taxes than its government has spent.
    b. is owed money from other foreign and international government agencies.
    c. has positive net external wealth.
    d. has negative net external wealth.

ANSWER: d

60. A nation's external wealth can be affected by which of the following?
I. the difference between international spending and income from the rest of the world
II. changes in currency values
III. capital gains and losses on equities and real estate
    a. I
    b. II and III
    c. I and III
    d. I, II, and III

ANSWER: d

61. A country's external wealth can fall:
    a. when it records a surplus in the current account.
    b. when the value of its foreign liabilities decreases.
    c. when the value of its foreign assets rises.

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d. when its exports increase, all else being equal.

ANSWER: b

62. A country's external wealth is equal to:
    a. its exports minus imports.
    b. its overall debt.
    c. its foreign assets minus its foreign liabilities.
    d. the amount the country's citizens have invested abroad.

ANSWER: c

63. Suppose that a loan made in euros has experienced a capital gain. This could indicate that the:
    a. dollar appreciated.
    b. dollar depreciated.
    c. euro depreciated.
    d. dollar experienced a capital loss.

ANSWER: b

64. When a country makes a loan in its own currency and its currency depreciates, it experiences:
    a. a capital gain.
    b. a capital loss.
    c. a capital depreciation.
    d. neither a capital gain nor a capital loss.

ANSWER: d

65. When an individual's income is smaller than his or her expenditure, the individual CANNOT:
    a. borrow money.
    b. draw down his or her savings.
    c. print his or her own money.
    d. take another job to increase his or her income.

ANSWER: c

66. A nation with a relatively high country risk factor would MOST likely have:
    a. stable exports and unstable imports.
    b. low levels of external debt.
    c. excessive levels of spending compared with its income and current account surpluses.
    d. unstable exports, a high level of external debt, and excessive levels of spending.

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ANSWER: d

67. International lenders want to know the likelihood that a nation will repay its debt. Therefore, they rely on:
    a. collateral.
    b. international ratings of country risk.
    c. the faith and credit of the sovereign nation.
    d. advice from the International Monetary Fund (IMF).

ANSWER: b

68. To analyze whether an international private or sovereign borrower will repay a loan, creditors resort to:
    a. collateral requirements for loans.
    b. International Monetary Fund expertise.
    c. international credit rating agencies that operate much like they do in sophisticated financial markets.
    d. incentives to repay, such as threats of foreclosure, force, or economic sanctions for delinquent borrowers.

ANSWER: c

69. What is country risk?
    a. the risk that the nation will suffer unemployment and inflation as a result of its economic policies
    b. the additional risk inherent in investing in a foreign country, relative to U.S. Treasury bonds
    c. the risk of currency depreciation on foreign liabilities
    d. the total of the government's national debt plus private debt owed to international creditors

ANSWER: b

70. Emerging market countries are:
    a. countries with high levels of income per person that are well integrated into the global economy.
    b. mainly countries that are growing and becoming more integrated into the global economy.
    c. mainly countries that are not yet well integrated into the global economy and are not democratic.
    d. countries with low levels of income per person.

ANSWER: b

71. Which of the following credit ratings is MOST favorable?
    a. BBB+
    b. BBB–
    c. CC
    d. D

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ANSWER: a

72. A credit rating of A means:
    a. easy access to low-interest loans.
    b. more limited credit and possibly punitive interest rates.
    c. higher interest rates.
    d. you can set your own interest rates.

ANSWER: a

73. A country with a credit rating of A is likely to have:
    a. a history of defaulting on its debt.
    b. an unstable exchange rate.
    c. political stability.
    d. a surplus of imports over exports.

ANSWER: c

74. What remedy does an international lender have against a foreign borrower who defaults?
    a. It can foreclose on the collateral and sell it.
    b. It can sue the borrower in the international credit court.
    c. The national government will always pay up and make the loan good.
    d. Usually, there is no remedy.

ANSWER: d

75. Governments affect international financial relationships through their policy regimes. A policy regime includes:
    a. economic philosophies like liberalism and Marxism.
    b. specific laws and regulations affecting investment, reserves, or credit.
    c. larger sets of rules that define a general context to which specific laws or regulations conform.
    d. very broad legal, social, political, and commercial structures that influence economic behavior.

ANSWER: c

76. Governments affect international financial relationships through their institutions. These might include:
    a. border controls regulating goods coming into or leaving from the nation.
    b. laws or regulations affecting investment, reserves, or credit.
    c. larger sets of rules that define a general context to which specific laws or regulations conform.
    d. very broad legal, social, political, and commercial structures that influence economic behavior.

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ANSWER: d

77. Recent research has found that a country's institutions:
    a. are a causal factor in economic prosperity.
    b. are the result of economic prosperity.
    c. have nothing to do with economic prosperity.
    d. can be easily reformed as an economy changes.

ANSWER: a

78. What is the difference between an open economy and a closed economy?
    a. A closed economy has sealed borders and allows no tourism or migration.
    b. An open economy has very few restrictions on trade or financial flows.
    c. A closed economy has very tough wage and hour laws and will not tolerate labor unions.
    d. An open economy has lax restrictions on drugs or other illegal activities.

ANSWER: b

79. One indicator of international financial openness in advanced countries is that:
    a. defaults by borrowers have decreased significantly.
    b. cross-border financial transactions in advanced nations have increased tenfold.
    c. restrictions on mortgage lending or bank capital requirements have decreased.
    d. governments no longer try to control interest rates.

ANSWER: b

80. Since 1970, governments worldwide have:
    a. discouraged trade and raised levels of protection for workers.
    b. discouraged international investment to favor domestic financial markets.
    c. rejected globalization because it makes a nation more vulnerable.
    d. lifted barriers to international capital movements and trade.

ANSWER: d

81. In general, we currently classify nations into three categories, depending on the level of economic advancement. These are:
    a. advanced, emerging, and developing.
    b. high achievers, low achievers, and infant industry nations.
    c. First World, Second World, and Third World.
    d. fully integrated, moderately integrated, and closed.

ANSWER: a

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82. The advanced nations:
    a. were least open to globalization and free movement of capital.
    b. led the movement toward globalization and openness during the 1980s.
    c. had to compete with the developing nations and finally learned that financial openness was beneficial to their economies.
    d. were not as open to globalization as were the emerging markets.

ANSWER: b

83. A consequence of the world movement toward financial integration and openness is:
    a. depreciating exchange rates.
    b. financial interdependence coupled with a tenfold increase in the volume of foreign assets.
    c. a retreat toward safety and heavier regulation of financial flows.
    d. dominance by the United States as the only destination for investment funds.

ANSWER: b

84. Nations are free to choose and use their own currency and control its value. Normally, they must choose between a _____ regime.
    a. fixed or floating exchange rate
    b. variable or stable exchange rate
    c. controlled or laissez-faire
    d. centrally planned or market-based

ANSWER: a

85. What is the Eurozone?
    a. a common European defense system supplemented by radar and strategic monitoring systems
    b. a trade agreement among the nations of Europe not to impose tariffs on one another
    c. a group of European nations that have adopted a common currency
    d. regions of the world that allow traders to make bank deposits in euros

ANSWER: c

86. The idea of dollarization is:
    a. the use of domestic currency in a variable proportion with neighboring countries' currency.
    b. the use of the U.S. dollar for paying the native country's debt.
    c. a nation's use of a foreign currency over which it has no policy control.
    d. the use of domestic currency in countries in Europe that are not part of the European Union.

ANSWER: c

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87. Countries that adopt "dollarization" will:
    a. fix their exchange rate to the U.S. dollar.
    b. be positioned to influence U.S. monetary policy.
    c. surrender control of monetary policy to the United States.
    d. be less integrated in the world economy.

ANSWER: c

88. Economic institutions are important in helping to govern and determine economic outcomes. Which of the following would NOT be an example of an economic institution?
    a. various regulatory agencies, such as the Securities and Exchange Commission, that affect the integrity of the investment community
    b. First National Bank of Chicago
    c. a legal system that establishes and protects private property rights
    d. disclosure provisions in investment contracts

ANSWER: b

89. Poor governance often results in:
    a. lower levels of income volatility.
    b. more poverty and macroeconomic shocks.
    c. higher levels of income per capita.
    d. consistent application of governmental policy.

ANSWER: b

90. The Great Divergence refers to:
    a. the widening U.S. trade deficit.
    b. the growing gap between rich and poor workers.
    c. the growing Chinese trade surplus.
    d. the gap in income per capita between rich and poor nations.

ANSWER: d

91. Income per person in advanced countries is _____ that in poor nations.
    a. roughly the same as
    b. ten times lower than
    c. ten times greater than
    d. more than fifty times greater than

ANSWER: d

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92. Policies that work well in stable, well-governed nations:
    a. may not work well in poor nations if these nations lack stability and good governance.
    b. should be looked at as an alternate policy regime for poor nations.
    c. often do not represent the best policies for other rich nations.
    d. tend to be less desirable during election years or in times of political upheaval.

ANSWER: a

93. Economists say that the relationship between good institutions and good economic results is that:
    a. good institutions are essential to good economic outcomes.
    b. good economic outcomes enable a society to build good institutions.
    c. good institutions are not necessary for good government and good economic outcomes.
    d. good economic results are usually based on access to essential natural resources and a competent labor force—not on access to societal institutions.

ANSWER: a

94. Optimal policies and policy regimes generally:
    a. require standard approaches.
    b. require different approaches in rich and poor countries.
    c. have similar results in both rich and poor countries.
    d. require the government to be authoritarian.

ANSWER: b

95. Countries with good institutions have:
    a. higher per capita income.
    b. greater income volatility.
    c. higher per capita income and greater income volatility.
    d. lower per capita income.

ANSWER: a

96. The main lessons of the study of international macroeconomics are that:
    a. there is a consensus regarding the best policies to follow.
    b. poor countries will become rich if they just adopt the institutions of the rich countries.
    c. financial openness will quickly lead to economic growth.
    d. the best policies to follow depend on the institutional structure of a country and the specific situation.

ANSWER: d

97. Macroeconomic problems in developing nations can be addressed by:

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Chapter 01

a. addressing behavior that raises the costs of establishing and operating businesses.
b. placing maximum emphasis on sound business practices and efficiency.
c. fostering a culture of consumption over savings.
d. increasing the size and scope of the government.

ANSWER: a

98. Counterproductive economic behavior such as _____ can be minimized by good institutions.
a. bribery
b. lobbying
c. favoritism
d. bribery, lobbying, and favoritism

ANSWER: d

99. Counterproductive economic behavior could be more prevalent in developing countries because of:
a. a shortage of strong institutions.
b. government interference in economic affairs.
c. overspending on defense.
d. insufficient social spending.

ANSWER: a

100. According to the text, there are two reasons we care so much about exchange rates. List and fully explain these reasons in your own words.

ANSWER: Suggested answer: Exchange rates cause the relative price of goods to fluctuate, affecting firms and households with international ties. If the exchange rate increases in value, it makes it less expensive for households to buy foreign goods and makes it harder for firms to sell their goods to foreigners. Also, exchange rates cause the relative price of assets to fluctuate, causing wealth to fluctuate for individuals, firms, and governments.

101. What is an exchange rate crisis, and what are its characteristics?

ANSWER: Suggested answer: A crisis is when there is a sudden and large drop in the value of a currency after a period in which the rate is relatively stable. The crises are usually marked by falling output and the emergence of banking and debt problems, and they are often followed by increased poverty, unemployment, and political turmoil.

102. Explain why and how a fall in the exchange rate of a country can lead to default.

ANSWER: Suggested answer: Since many of a country's liabilities are denominated in a foreign currency, a fall in the exchange rate effectively increases a country's real debt, making it more likely that it will default.

103. Explain what is meant by the globalization of finance, and describe the trends in this area since 1970. Be

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sure to distinguish between the trends in advanced, emerging, and developing countries.

ANSWER: Suggested answer: Financial globalization involves removing restrictions on cross-border transactions and allowing a country to hold foreign assets or sell domestic assets to foreigners. Advanced economies embraced financial globalization in the 1980s, and emerging markets began opening in the 1990s. Some developing countries have started to open, but they are not yet well integrated into the world economy.

104. Explain why the current account balance of the world is zero.

ANSWER: Suggested answer: The global economy is "closed." This means that each country that runs a deficit must be offset somewhere by a country that runs a surplus. Put another way, if a country is importing, another country must be exporting.

105. What is the relationship between income, expenditure, the current account, and external wealth?

ANSWER: Suggested answer: If a country has more income than expenditures, it will be running a current account surplus. A current account surplus implies that the country has rising external wealth.

106. What is the link between current account imbalances and country risk?

ANSWER: Suggested answer: When a country is experiencing a current account deficit, it is essentially borrowing and experiencing falling net external wealth. As this trend continues, it becomes more likely that the country will default on those obligations and country risk will rise (it will be charged higher interest rates due to lower credit ratings).

107. What are the differences between a policy, a regime, and an institution?

ANSWER: Suggested answer: A policy is a specific government choice. A regime is the set of rules under which a choice is made. Institutions are the broad legal, political, and social structures that drive behavior and give rise to the regime.

108. Compare and contrast policies, regimes, and institutions as they relate to government action.

ANSWER: Suggested answer: Policies are direct government actions taken in the economy, while regimes are the broader context of rules and norms. Institutions are even broader, as they involve the larger political, legal, social, and cultural structures that influence behavior.

109. Governance is an important element in economic success and prosperity for any nation. List at least four of the six dimensions presented in the text that are highly correlated with good economic outcomes.

ANSWER: Suggested answer: The textbook identifies six dimensions: voice and accountability, political stability, government effectiveness, regulatory quality, rule of law, and control of corruption.

110. The study of international macroeconomics will enable you to understand important issues and identify good solutions to problems and tensions. Name several items in the study of international macroeconomics that an understanding of which can help clarify and instruct policy and governance.

ANSWER: Suggested answer: Students may identify several of the following: currencies, exchange rates, trade balances, capital flows, financial imbalances, investment, international interest rates, international inflation rates, economic growth, and income.

111. What are the six characteristics of "good" institutions, and why are they considered good (i.e., what are the

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benefits of good institutions)?

ANSWER: Suggested answer: Good institutions are those with voice and accountability, political stability, effective government, a quality regulatory system, rule of law, and limited corruption. Those countries with good institutions typically have higher income per capita and lower volatility in income per capita.

112. What role does history play in the "Great Divergence"?

ANSWER: Suggested answer: The rich, colonizing powers may have set up good institutions if they planned to stay in a country based on the suitability of the land for agriculture and the climate for living. If instead they simply planned to extract wealth from the colonies, then they had no incentive to establish quality institutions.

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