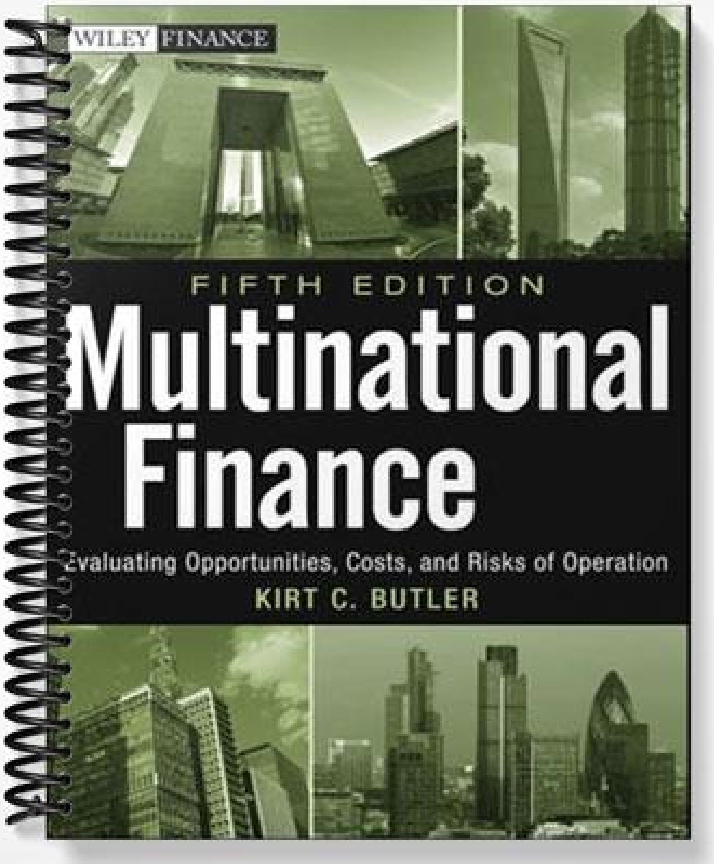
TEST BANK


WILEY FINANCE
FIFTH EDITION
Multinational Finance
Evaluating Opportunities, Costs, and Risks of Operation
KIRT C. BUTLER

File: ch02, Chapter 2: World Trade and the International Monetary System

True/False

1. Markets are integrated when an asset sells for the same price wherever it is traded.

   Ans: True

2. The world's financial markets are becoming increasingly segmented as large international commercial banks achieve more and more economic power.

   Ans: False
   Response: They are becoming increasingly integrated (that is, less segmented).

3. Prices in the world's financial markets are becoming increasingly segmented as local political forces work to dismantle many of the world's largest countries, such as those of the former Soviet Union.

   Ans: False
   Response: Markets are becoming more integrated (less segmented). Indeed, the breakup of the Soviet Union hastened the integration of these emerging markets into the rest of the world.

4. The international monetary system refers to the global network of governmental and commercial institutions within which currency exchange rates are determined.

   Ans: True

5. The International Monetary Fund's principal mission is to provide funds for economic development in developing economies.

   Ans: False
   Response: The IMF's role is to help countries defend their currencies against temporary balance-of-payments imbalances and to promote cross-border trade.

6. The Basel Accord established the International Monetary Fund and the World Bank.

   Ans: False

Response: These institutions were established by the Bretton Woods Agreement of 1946.

7. The "financial account" of the IMF's *Balance-of-Payments Statistics* measures the total financial wealth of citizens in each reporting country.

   Ans: False
   Response: The financial account measures cross-border transactions associated with changes in ownership of financial assets and liabilities.

8. The "trade balance" of the IMF's *Balance-of-Payments Statistics* is the net balance (exports minus imports) on merchandise trade.

   Ans: True

9. The "trade balance" of the IMF's *Balance-of-Payments Statistics* measures gross exports of goods and services.

   Ans: False
   Response: The trade balance is the net balance on merchandise trade.

10. In a fixed exchange rate system, governments stand ready to buy and sell currency at official exchange rates.

    Ans: True

11. Decreases in currency values within a fixed rate system are called devaluations.

    Ans: True

12. Decreases in currency values within a floating rate system are called devaluations.

    Ans: False
    Response: A decrease in a currency value in a floating rate system is called a depreciation.

13. Special Drawing Rights (SDRs) are distributed to commercial banks within the European Union (EU) in proportion to that member's proportion of EU trade.

Ans: False
Response: SDRs are IMF bookkeeping units of account that are traded only between central banks.

14. “The snake” refers to the serpentine path that exchange rates have followed since the introduction of the euro in 2002.

    Ans: False
    Response: It refers to the band within which the currencies of the European Monetary System traded.

15. Moral hazard is the risk that the existence of a contract will change the behaviors of parties to the contract.

    Ans: True

16. IMF loans to troubled economies are unlikely to change the behaviors of investors, because investors can assess the risks of moral hazard for themselves.

    Ans: False
    Response: The expectation of an IMF bailout creates a moral hazard, in that it changes the expectations and hence the behaviors of lenders, borrowers, and governments.

17. Subprime loans are loans that are issued at an interest rate below the prime rate.

    Ans: False
    Response: Subprime loans are loans to poor credit risks, and carry higher interest rates than prime.

18. Liquidity refers to the ease with which an asset can be exchanged for another asset of equal value.

    Ans: True

Multiple Choice

1. Factors contributing to market segmentation include each of the following EXCEPT
    a. informational barriers
    b. regulatory and institutional interference
    c. the immobility of human labor

   d. transactions costs
   e. All of the above contribute to market segmentation

Ans: e

2. The ______ of the IMF's *Balance-of-Payments Statistics* measures whether a particular country is a net importer or exporter of manufactured goods.
   a. current account
   b. financial account
   c. overall balance
   d. trade balance
   e. None of the above

Ans: d

3. The ______ of the IMF's *Balance-of-Payments Statistics* measures whether a particular country is a net importer or exporter of goods and services.
   a. current account
   b. financial account
   c. overall balance
   d. trade balance
   e. None of the above

Ans: a

4. The ______ of the IMF's *Balance-of-Payments Statistics* measures cross-border transactions associated with changes in ownership of financial assets and liabilities.
   a. current account
   b. financial account
   c. overall balance
   d. trade balance
   e. None of the above

Ans: b

5. The ______ of the IMF's *Balance-of-Payments Statistics* measures the sum of all private financial and economic transactions of the reporting economy with the rest of the world.
   a. current account
   b. financial account
   c. overall balance
   d. trade balance
   e. None of the above

Ans: c

6. Which of the following is NOT related to changes in currency values under managed exchange rate systems?
   a. business cycles
   b. inflation differentials
   c. politics
   d. the balance of payments
   e. Each of the above is related to changes in currency values in managed systems

Ans: e

7. When fixed exchange rate systems collapse, government officials most frequently blame ______ for precipitating the collapse.
   a. currency speculators
   b. foreign governments
   c. multinational corporations
   d. opposition politicians and their policies
   e. themselves

Ans: a

8. The problem with a fixed exchange rate system is that ______.
   a. domestic inflation is directly linked to inflation in other countries
   b. fixed exchange rates are hard to maintain when they diverge from market values
   c. labor conditions are isolated from the rest of the world
   d. Three of the above
   e. Two of the above

Ans: e

9. The ______ established the World Bank and the International Monetary Fund in 1946.
   a. Basel Accord
   b. Bretton Woods Agreement
   c. Louvre Accord
   d. Plaza Accord
   e. Treaty of Maastricht

Ans: b

10. Which of the following currencies is currently linked to the price of gold?

a. British pound
b. Japanese yen
c. U.S. dollar
d. All of the above
e. None of the above

Ans: e

11. Which of the following countries is currently participating in the single-currency Eurozone?
    a. Denmark
    b. Portugal
    c. Sweden
    d. Switzerland
    e. United Kingdom

Ans: b

12. Which of the following was LEAST likely to have caused the Mexican peso crisis of 1995?
    a. a shortage of foreign currency reserves at the Mexican central bank
    b. a weak economy
    c. an inflated value of the peso caused by pegged exchange rates
    d. short-term dollar borrowings by Mexican commercial banks and the government
    e. All of the above contributed to the crisis

Ans: b

13. Which of the following countries was MOST affected by the Asian contagion of 1997?
    a. China
    b. Korea
    c. Japan
    d. Singapore
    e. Taiwan

Ans: b

14. Which of the following was LEAST affected by the Asian contagion of 1997?
    a. China
    b. Korea
    c. Indonesia
    d. Thailand
    e. the International Monetary Fund

Ans: a

15. Financial aid packages provided by the IMF to countries in a currency crisis are often tied to reforms that include ______.
    a. a coup d'état
    b. changes in ruling parties
    c. financial market liberalizations
    d. imposition of military rule to reestablish stability
    e. None of the above

Ans: c

16. Common elements in many currency crises include each of the following EXCEPT
    a. a fixed exchange rate system that overvalued the local currency
    b. a large amount of foreign currency debt
    c. a precipitous drop in the value of the local currency
    d. IMF intervention to provide short-term assistance
    e. All of the above are common during currency crises

Ans: e

17. Critics of IMF lending policies during financial crises FAVOR which of a) through d)?
    a. fiscal restraint
    b. immediate financial market liberalization
    c. monetary restraint
    d. temporary IMF loans
    e. Critics are against each of these policies

Ans: e

18. Causes of the global financial crisis of 2008 included each of the following EXCEPT
    a. a lack of financial market liquidity
    b. a lack of regulatory oversight of mortgage lending
    c. lax credit requirements for U.S. homeowners
    d. subprime loans of poor credit quality
    e. the divergence in economic performance between developed and emerging market economies

Ans: e

19. One of the first symptoms of the 2008 financial crisis was _______.
    a. a decrease in the default risk of collateralized debt obligations (CDOs)
    b. currency market volatility

c. a wave of corporate bankruptcies and government bailouts
d. government intervention in the currency markets
e. illiquidity in the market for collateralized debt obligations (CDOs)

Ans: e