Below you will find some multiple choice questions. Answer each of them by choosing the appropriate option and briefly explaining why you choose it.

1. Risk sharing through international portfolio diversification reduces volatility in
   (a) gross national product (GDP)
   (b) gross national income (GNI)
   (c) exchange rates
   (d) investment expenditure
   (e) all of the above

2. The theory of exchange rate overshooting is an explanation of the empirical observation that exchange rates
   (a) are sticky
   (b) are volatile
   (c) are overvalued for rich countries
   (d) are affected by a risk premium

3. Under the Gold Standard
   (a) it was easy to maintain internal balance
   (b) it was easy to maintain external balance
   (c) only the U.K. pegged its currency to gold
   (d) all countries held dollars as reserves

4. Because Panama is a currency board, it cannot
   (a) hold foreign reserves
   (b) have a current account deficit
   (c) have a government budget deficit
   (d) run out of foreign reserves

5. Financial globalization means that a country can use international borrowing to smooth consumption over a temporary fall in output by running a
   (a) current account deficit
   (b) current account surplus
   (c) government budget deficit
   (d) government budget surplus
6. The Bretton Woods system was unsustainable
   (a) because Britain ran short of reserves
   (b) because the IMF adjusted parities
   (c) because of external imbalances in the U.S.
   (d) because European countries needed seigniorage revenue to fight World War I.

7. Suppose India fixes its exchange rate, with complete sterilization of foreign exchange operations. If India faces a balance of payments surplus, how does this affect the central bank’s balance sheet?
   (a) Foreign assets rise, money in circulation rises.
   (b) Domestic assets rise, money in circulation falls.
   (c) Domestic assets rise, foreign assets rise.
   (d) Foreign assets rise, domestic assets fall.

8. Which of the following would suggest the U.K. should join the European Monetary Union?
   (a) Britain trades less with U.S. than with Europe.
   (b) British workers are not willing to move abroad.
   (c) Britain tends to have recessions at different times that France and Germany.
   (d) Britain does not receive much money from the European Union general funds.

9. If the U.S. has a trade deficit this year of $400 billion and net income from abroad of $100 billion, then what is happening to the U.S. net ownership of foreign assets during the year? (Assume KA=NUT=0.)
   (a) U.S. acquires $500 billion in assets.
   (b) U.S. acquires $300 billion in assets.
   (c) U.S. loses $300 billion in assets.
   (d) U.S. loses $500 billion in assets.

10. Which of the following is NOT a benefit of a country being open to the international financial market?
    (a) Smooth consumption.
    (b) Risk sharing.
    (c) Current account balance.
    (d) Efficient investment expenditure.