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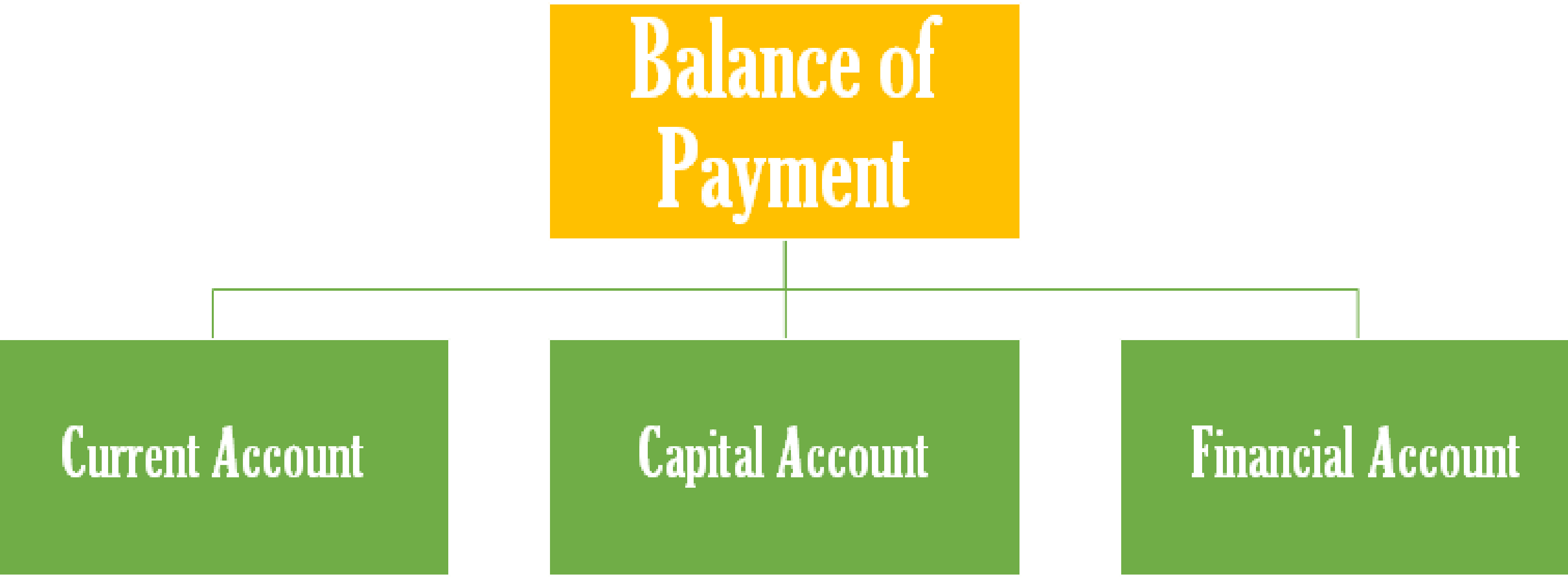
BALANCE OF PAYMENT MCQS



ECONOMIC & SOCIAL ISSUES - MULTIPLE CHOICE QUESTIONS

Economic & Social Issues - Multiple Choice Questions (MCQs)

Balance of Payment (BoP)

Q.1. Balance of Payment (BOP) of a country can be defined as-

A. A systematic statement of all economic transactions between different states to estimate the GST generated from each state.

B. It is the balance of loans to be paid to other countries and organisations like the IMF only.

C. Balance of Payment (BOP) of a country can be defined as a systematic statement of all economic transactions of a country with the rest of the world during a specific period.

D. All of the above.

Answer: C

Explanation-

- Balance of payment may sound like the debt which a country needs to pay but it is not the case.
- The systematic accounting is done on the basis of double entry bookkeeping (both sides of transactions credit and debit are included).
- Economic transaction includes all such transactions that involve the transfer of title or ownership of goods and services, money, and assets.
- All trades conducted by both the private and public sectors are accounted for in the BOP in order to determine how much money is going in and out of a country.
- Hence option C is right.

Q.2. The balance of payment is calculated because-

A. To reveal country’s debt status

B. BOP helps to indicate the country’s currency devaluation.

C. BOP statement helps the government to decide on the fiscal and trade policies.

D. All of the above

Answer: C

Explanation-

- BOP does not just mean the repayment of loans; it is the statement of transaction and includes both credit and debit.
- If a country has surplus BOP (credit more than debit), which results in the increase in the value of that country's currency. So, BOP indicates both appreciation and depreciation of country's currency.
- Depending upon the status of BOP, the country formulates the fiscal (tax related) and trade policies, as it acts as a report card and exposes the areas which needs attention.
- Hence option C is correct.

Q.3. Current account includes-

A. Credits and debits on the trade of merchandise, which includes goods such as raw materials and manufactured goods that are bought, sold or given away .

B. credits and debits on the trade of merchandise, along with services like tourism etc.

C. Receipts from income-generating assets such as stocks (in the form of dividends).

D. unilateral transfers which are credits that are mostly worker's remittances, which are salaries sent back into the home country of a national working abroad, as well as foreign aids that are directly received.

E. All of the above.

Answer: E

Explanation-

- It includes export and import of gods and services i.e., visible, and invisible trade. This type of transaction changes (increase or decreases) the current level of consumption of the country.
- Within the current account are credits and debits on the trade of merchandise, which includes goods such as raw materials and manufactured goods that are bought, sold, or given away (possibly in the form of aid). Services refer to receipts from tourism, transportation (like the levy that must be paid in Egypt when a ship passes through the Suez Canal), engineering, business service fees (from lawyers or management consulting, for example), and royalties from patents and copyrights. When combined, goods and services together make up a country's balance of trade (BOT).

- The BOT is typically the biggest bulk of a country's balance of payments as it makes up total imports and exports. If a country has a balance of trade deficit, it imports more than it exports, and if it has a balance of trade surplus, it exports more than it imports.
- Receipts from income-generating assets such as stocks (in the form of dividends) are also recorded in the current account.
- The last component of the current account is unilateral transfers. These are credits that are mostly worker's remittances, which are salaries sent back into the home country of a national working abroad, as well as foreign aids that are directly received.

Q.4. Capital account is related to.

A. Sales and purchase of assets both financial and non-financial.

B. Investments are not related to capital account.

C. Foreign exchange reserves are included in capital account.

D. Purchase and sale capital goods only.

Answer: C

Explanation-

- While understanding the term capital account, we must focus on the word capital.
- Capital is something which is an asset and can be used in income generation.
- In capital account, transaction is noted in terms of capital, which tells us how attractive the country is for investment to the foreigners.
- Taxes, non-financial assets, investments, and fixed goods are included in capital account.
- Financial assets are included in current account and these types of assets are in the final form, while the assets in capital accounts are in intermediate form.

Q.5. When we compare BOP and BOT we understand-

A. BOP and BOT can be used interchangeably.

B. Both indicate the economic prosperity to the same extent.

C. BOT is the subset of BOP.

D. All of the above

Answer- C

Explanation

- BOP and BOT are different terms.
- They both are indicative of the economic prosperity BUT they do it to different extent,
- BOT includes- merchandise trade and services only,
- While BOP includes- both goods and services, transaction of capital nature (asset or liability generating) as well as unilateral transfers.
- Therefore, it can be said that BOT is a subset of BOP.

Q.6. Current account convertibility is-

A. It is the freedom of convertibility of domestic currency into foreign currency regardless of the purpose of conversion.

B. It is the freedom of convertibility of domestic currency into foreign currency and vice a versa for trade in goods and invisibles.

C. Current account convertibility is applicable only to convert domestic currency into foreign currency and not the other way round.

D. None of the above.

Answer: B

Explanation-

- In currency convertibility there are two parts- current account convertibility and capital account convertibility, and both of them indicate the purpose of the conversion of currency.
- Currency convertibility is always flexible in two ways, (domestic to foreign and foreign to domestic), and applies to both capital and current account convertibility.
- Current account convertibility specifically deals with the conversion of currency for the purpose of trade and invisible only.

Hence option B is right.

Q.7. Capital account convertibility is related to-

A. Freedom to invest in financial assets of other countries.

B. It does not allow foreign investors to purchase Indian financial asset.

C. The definition was CAC was given by Rangarajan committee.

D. All of the above

Answer: A

Explanation-

- CAC is freedom of foreign investors to purchase Indian financial assets and that of domestic citizens to purchase foreign financial assets, hence A is right, and B is wrong.
- The Committee on capital account convertibility was S.S. Tarapore committee which gave the definition of CAC.

Q.8. Foreign exchange reserves are related to-

A. Assets denominated in foreign currency which are held by central as well as commercial banks of the country.

B. India's foreign exchange reserves comprises of FCA (foreign currency assets), gold, SDR with IMF and reserve tranche position in the IMF.

C. It is used as a primary source for payment loans.

D. All of the above.

Answer- B

Explanation-

- Foreign exchange reserves are assets denominated in foreign currency that are held by central bank (RBI) and not commercial banks.
- It is kept as a cushion against any potential balance of payment related crisis.
- Hence option B is correct.

Q.9. Managed exchange rates are-

A. Mix of both fixed and flexible exchange rate with IMF tries to manipulate the exchange rates.

B. The only way government tries to manipulate exchange rate in ‘managed exchange rate’ is by buying and selling foreign currency or indirectly my monetary policy.

C. Not many countries follow managed exchange rate.

D. All of the above

Answer: B

Explanation-

- A country follows a mix of both Fixed and flexible exchange rate system wherein the government attempts to manipulate the exchange rate directly by buying/selling foreign currency or indirectly by monetary policy.
- Most of the economies these days follow managed exchange rate system.
- Hence option B is right.

Q.10. Depreciation means-

A. When the exchange rate of a domestic currency is cut down by its government against a foreign currency.

B. When domestic currency loses its value in front of a foreign currency in a market driven situation.

C. Devaluation and depreciation a can be used interchangeably.

D. None of the above

Answer: B

Explanation-

- When domestic currency loses its value in front of a foreign currency in a market driven situation then it is termed as “Depreciation”
- When the currency loses its values because of government intervention it is called as devaluation.

- Devaluation and depreciation have the same result i.e. decrease in the value of currency BUT the former happens according to government intervention and later by market forces.
- Hence option B is correct.

Q.11. Hard currency is-

A. Is the currency in which the greatest number of transactions takes place in the world?

B. A currency can be hard and soft at the same time.

C. Has nothing to do with liquidity.

D. All of the above.

Answer- A

Explanation-

- It is that currency in which the greatest number of transactions take place globally in short which is the most liquid. Hence option A is right, and C is wrong.
- In contrast, soft currencies may depreciate in value rapidly and they are difficult to convert into foreign currencies. Hence a currency cannot be hard and soft at the same time.

Q.12. When government starts repurchasing the bonds before their maturities the money which flows into the economy is known as-

A. Dear money

B. Heated Currency

C. Cheap Currency

D. None of the above

Answer: C

Explanation:

Heated Currency: When the hard currency is exiting a economy at a faster pace it is under enough pressure of depreciation. Also called as currency under heat or under hammering.

Cheap Currency: When government starts repurchasing the bonds before their maturities the money which flows into the economy is known as the cheap currency/cheap money.

Dear Currency: Dear money as it is also called when government issues bonds and when the money starts flowing from the system to the government the currency would become dearer.

Q.13. Which of the statement is right?

A. India has both current and capital account convertibility.

B. In India there is current account convertibility since the independence.

C. In India capital account was made convertible since 2007.

D. India has partial convertibility.

Answer: D

Explanation:

- India entered full current account convertibility since August 20 11993, hence option B is incorrect.
- In case of capital account India still has certain restrictions where it has not made it fully convertible (40:60). Hence option A and C are wrong.
- Since India has full current account convertibility and has restriction on capital account. Option D is correct.

Q.14. Interests rates

A. Have no influence on the value of country's currency.

B. Have impact on the attractiveness of the economy in the eyes of investors.

C. It is possible that high interest rates can lead to depreciation of currency.

D. All of the above.

Answer- B

Explanation:

- Interest rate is the return which we get on investments.
- When a country has offers high interest rates, it attracts investors around the world, which leads to the increase in the value of that currency.
- Interests rates and exchange rates go in tandem which means they are directly proportional. Increase in interest rates ultimately leads to increase in exchange rate.
- Hence option B is correct.

Q.15. In relation to income and exchange rates-

A. Increase in income compulsorily leads to increase in exchange rate.

B. Increase in income may or may not lead to increase in exchange rate.

C. Consumption pattern has nothing to do with exchange rate.

D. All of the above

Answer- B

Explanation:

- When income increases, consumer spending increases.
- Spending on imported goods is also likely to increase.
- There is a depreciation of the domestic currency.
- If there is an increase in income abroad as well, domestic exports will rise.
- On balance, the domestic currency may or may not depreciate. What happens will depend on whether exports are growing faster than imports.
- In general, other things remaining equal, a country whose aggregate demand grows faster than the rest of the world's normally finds its currency depreciating because its imports grow faster than its exports.

Hence option B is right.

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