CHAPTER-6 | Open Economy Macroeconomics

QUIZ PART-05

1. **If the import function is M = 60 + 0.06Y, the Marginal Propensity to Import (MPI) is:**
   A. 60
   B. 0.06
   C. 0.60
   D. 6 (B)

Explanation : MPI is the coefficient of Y in the import function, which here is 0.06.

2. **Why is the open economy multiplier smaller than the closed economy multiplier?**
   A. Because exports reduce demand
   B. Because taxes increase demand
   C. Because imports leak income out of the domestic economy
   D. Because savings vanish completely (C)

Explanation: In an open economy, part of income is spent on imports, reducing the domestic multiplier effect.

3. **In a closed economy, the multiplier effect is larger because:**
   A. All extra income is spent domestically
   B. Imports add to total demand
   C. Exports are included in AD
   D. Inflation reduces demand (A)

Explanation: In a closed economy, all additional income is spent within the domestic economy, leading to a larger multiplier effect.

4. **If C = 40 + 0.8YD, T = 50, I = 60, G = 40, X = 90, and M = 50 + 0.05Y, equilibrium income is found by:**
   A. Solving AD = AS with given functions
   B. Multiplying investment by MPC
   C. Setting exports equal to imports
   D. Ignoring taxes and imports (A)

Explanation : Equilibrium income is obtained by equating aggregate demand (C + I + G + X – M) to aggregate supply (Y) with the given data.

5. **If exports increase from 90 to 100 in the above case, the equilibrium income will:**
   A. Fall
   B. Remain unchanged
   C. Rise
   D. Become negative (C)

Explanation: An increase in exports raises aggregate demand, which increases equilibrium income.

6. **According to Purchasing Power Parity (PPP), if prices double in India over 20 years while staying constant in the USA, the rupee will:**
   A. Appreciate against the dollar
   B. Depreciate against the dollar
   C. Remain unchanged
   D. Be fixed by RBI (B)

Explanation: Higher domestic inflation causes the rupee to depreciate relative to the dollar under PPP theory.

7. **If inflation is higher in country A than in country B under a fixed exchange rate, trade balance of country A will:**
   A. Show a surplus
   B. Show a deficit
   C. Remain balanced
   D. Improve exports (B)

Explanation: Higher inflation in country A makes its goods costlier, increasing imports and causing a trade deficit.

8. **A current account deficit should not always be considered alarming because:**
   A. It always indicates a balanced budget
   B. It is offset by capital account surplus
   C. It reduces exports
   D. It permanently weakens the economy (B)

Explanation: Current account deficit can be financed by capital account surplus, so it is not always a cause for concern.

9. **Managed floating exchange rate system is also called:**
   A. Gold Standard
   B. Clean float
   C. Dirty float
   D. Fixed rate system (C)

Explanation: In managed floating (dirty float), central banks intervene to reduce excessive exchange rate fluctuations.

10. **Which of the following is a role of the central bank under managed floating?**
    A. Eliminate foreign trade
    B. Intervene by buying/selling foreign currency
    C. Fix exchange rates permanently
    D. Abolish reserves completely (B)

Explanation : Central banks intervene in foreign exchange markets by maintaining reserves and controlling volatility in exchange rates.