1. What is an open economy?
A. An economy that only produces domestic goods
B. An economy that avoids international trade
C. An economy that interacts with other countries through trade and financial markets
D. An economy that does not use currency (C)

Explanation : An open economy engages in trade in goods, services, and financial assets with other countries

2. Which of the following is a component of the current account?
A. Foreign Direct Investment
B. External commercial borrowings
C. Transfers and trade in services
D. Purchase of foreign assets (C)

Explanation : The current account includes transfers, trade in goods, and trade in services.

3. What does a surplus in the current account signify?
A. The country is borrowing from other countries
B. The country is self-sufficient
C. The country is lending to other countries
D. The country is not importing anything (B)

Explanation : A current account surplus means the country earns more from exports and transfers than it spends on imports.

4. What is recorded in the capital account of the balance of payments?
A. Imports and exports of goods
B. Gifts and grants
C. Purchase and sale of assets
D. Income from tourism (C)

Explanation : The capital account includes transactions involving financial assets and liabilities.

5. What is the exchange rate?
A. Rate at which gold is exchanged for currency
B. Value of one currency in terms of another currency
C. Interest rate offered by central banks
D. Tax rate on exports (B)

Explanation : The exchange rate is the price of one currency expressed in terms of another currency.

6. What leads to depreciation of the domestic currency in a flexible exchange rate system?
A. Fall in imports
B. Increase in foreign currency reserves
C. Increase in demand for foreign exchange
D. Reduction in income (C)

Explanation : Increased demand for foreign exchange causes domestic currency to depreciate.

7. What does purchasing power parity (PPP) mean?
A. Equal interest rates across countries
B. Equal tax systems
C. Exchange rates adjust so product costs the same across countries
D. Governments set the same exchange rate (C)

Explanation : PPP implies exchange rates adjust so that identical goods cost the same in different countries.

8. In a fixed exchange rate system, what is the role of the central bank?
A. Avoid any market intervention
B. Sell government bonds
C. Intervene to maintain the exchange rate
D. Only set interest rates (C)

Explanation : In a fixed rate system, central banks intervene in the market to maintain the official rate.

9. What happens when there is a balance of payments deficit?
A. Government raises taxes
B. Foreign exchange reserves increase
C. Capital inflows reduce
D. Central bank sells foreign reserves (D)

Explanation : To cover a BoP deficit, central banks sell foreign currency from reserves.

10. What is the effect of a high marginal propensity to import in an open economy?
A. Multiplier increases
B. Consumption decreases
C. Imports decrease
D. Multiplier becomes smaller (D)

Explanation: A high import propensity leads to leakages, thus reducing the multiplier.