INDIAN SCHOOL AL WADI AL KABIR

Class: XII	Department: Commerce
Worksheet: 1	Topic: BALANCE OF PAYMENT (OPEN ECONOMY)

1. **The foreign exchange is determined by _______.**
    a. The demand for foreign currency
    b. The supply of foreign currency
    c. Supply and demand in the foreign exchange market
    d. None of the above
2. **Which of the following statements about the balance of payments is correct?**
    a. Exchange control is a measure intended to improve the adverse balance of payments
    b. Import substitution is a measure intended to improve the adverse balance of payments
    c. Currency devaluation is a measure intended to improve the adverse balance of payments
    d. All of the above

3. Which of the following is a type of foreign exchange market?

a. Forward market
b. Spot market
c. Both a and b are correct
d. Both a and b are incorrect

4. **The structure of the balance of payment accounts includes the _______.**

a. Capital account
b. Current account
c. Both a and b are correct
d. Both a and b are incorrect

5**. Dirty floating is related to:**
a. Fixed system of exchange rate
b. Flexible system of exchange rate
c. Both of these
d. None of these

6. Current account records transactions relate to:
a. Export and import of goods
b. Non-factor and factor income
c. Current transfers
d. All of these

7. Which of the following items relate to bop on capital account?

a. Foreign investment
b. Loans
c. NRI remittances
d. All of these

8. Unilateral transfer are:

a. One-sided payments
b. Reciprocal payments
c. Factor incomes
d. All of these

9. The foreign exchange is determined by___.

a. The demand for foreign currency
b. The supply of foreign currency
c. Supply and demand in the foreign exchange market
d. None of the above

10. One of the advantages of a fixed exchange rate is___.

a. It helps to induce capital from abroad
b. It helps to increase capital formation
c. It helps to promote foreign trade
d. All of the above

11. One of the demerits of a flexible exchange rate is______.

a. Uncertainty
b. Instability of foreign exchange
c. Adverse results due to the low rate
d. All of the above

12. The foreign exchange transactions that are dependent on other transactions are known as__________.

a. Autonomous transactions
b. Accommodating transactions
c. Current account transactions
d. None of the above

13. The structure of the balance of payment accounts includes the______.

a. Capital account
b. Current account
c. Both a and b are correct
d. Both a and b are incorrect

14. The records of exports and imports in goods and services and transfer payments is known as:

a) Current account
b) Budget surplus
c) Economic leakage
d) degree of openness

15. **Due to depreciation of foreign currency, the supply of foreign currency in domestic economy will:**
    a. Increase
    b. Not change
    c. Either increase or decrease
    d. Decrease

Assertion Reasoning Questions:

Read the following statements: Assertion (A) and Reason (R). Choose one of the correct alternatives given below:

Alternatives:

a) Both Assertion and Reason are true and Reason (R) is the correct explanation of Assertion (A).
b) Both Assertion and Reason are true and Reason (R) is not the correct explanation of Assertion (A)
c) Assertion (A) is True but Reason (R) is False
d) Assertion (A) is False but Reason (R) is True

1. **Assertion (A):** External assistance is recorded on the capital account of BOP.
   Reason (R): External assistance is recorded on the current account of BOP.

2. **Assertion (A):** Increased lending to abroad is recorded on the debit side of the capital account of BOP.
   Reason (R): Lending affects the asset and liabilities of the economy and involves the outflow of income.

3. **Assertion (A):** Export and import of machines is recorded on the capital account of BOP.
   Reason (R): Export and import of machines is the export and import of goods. So, it is recorded on the current account of BOP.

4. **Assertion (A):** Purchase of secondhand machinery from abroad is not recorded on the current account of BOP.
   Reason (R): The sale and purchase of secondhand goods are included in the current account of BOP.

5. **Assertion (A):** Foreign investment is recorded in the capital account of BOP.
   Reason (R): Foreign investments (eg. FDI) are the international transaction of assets during a fiscal year. So, they are recorded on the capital account of BOP.

6. **Assertion (A):** The difference between value of export and import of goods and services is called the trade balances.
   Reason (R): Trade balance is the difference between value of exports of goods and value of imports of goods. It does not include exports and imports of services.

1. **'Devaluation and Depreciation of currency are one and the same thing'. Do you agree? How do they affect the exports of a country?**
    1. Devaluation refers to reduction in price of domestic currency in terms of all foreign currencies under fixed exchange rate regime, i.e., (It takes place due to government).
    2. Depreciation refers to fall in market price of domestic currency in terms of a foreign currency under flexible exchange rate regime, i.e., (It takes place due to market forces of demand and supply)

   Currency Depreciation and Currency Devaluation may result into increase in exports of the goods and services from the country since it would increase the global competiveness of the goods.

2. **What determines the flow of foreign exchange into the country?**

   The following variables contribute to the flow of foreign exchange into the country:

- Foreigners purchasing domestic goods, in terms of exports.
- Foreigners buying the assets of the home country.
- In-country foreign direct investment and portfolio investment.
- Foreign exchange speculative buying, that will lead to inflow of the foreign exchange.
- Foreign tourists visiting various locations in India.

3. **Distinguish between current account and capital account of Balance of Payments accountMention; any two transactions of capital account.**

The Balance of Payments on capital account includes capital transactions relating to borrowing and; lending of capital, sale and purchase of assets, interest payment, etc.
The Balance of Payments on current account is the sum of balance of merchandise trade, services; and net transfers received from rest of the world.
The two transactions of capital account are:

- Direct investment
- Private transactions

4. **State any four items each of current account and capital account of the Balance of Payments account.**

Items of Current Account
(i) Export and Import of Goods: Current account shows exports and imports of visible items i.e., goods like machinery, wheat, steel, etc.
(ii) Export and Import of Services: Current account shows exports and imports of invisible items i.e., services like banking, tourism, insurance, etc.
(iii) Unilateral Transfers: These are those receipts which residents of a country receive or payments that the residents of a country make without getting anything in return. Receipts from abroad are entered as positive items and payments abroad are entered as negative items.
(iv) Private Transfers: These are gifts that domestic residents receive from or make to foreign residents.
Items of Capital Account

- Private Transactions: These are transactions that affect the assets or liabilities of individuals, business, etc. and other non-government entities.
- Official Transactions: These are the transactions that affect the assets and liabilities by the government and its agencies.
- Direct Investment: Direct investment means the act of purchasing an asset and at the same time acquiring control of it.
- Portfolio Investment: It is the acquisition of an asset that does not give the purchase control over the asset.

5. Define "Trade surplus". How is it different from "Current account surplus"?

Trade surplus refers to excess of value of export of visible items over value of import of visible items in the balance of payment account of a country. In other words, it only includes trade of goods. Current account surplus refers to excess of receipts from value of exports of visible items and invisible items; and unilateral transfers over payment for value of imports of visible items and invisible items; and unilateral transfer. It is a relatively broader concept as compared to trade surplus.

6. Where will sale of machinery to abroad be recorded in the Balance of Payments Accounts? Give reasons.

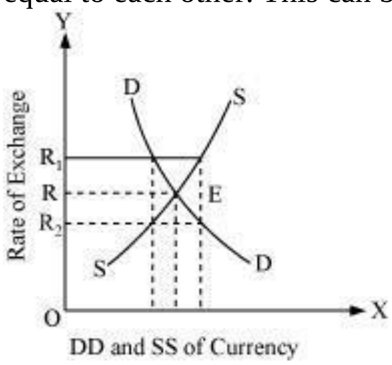
Machinery is a visible item and its sale to abroad will be an export. This will result in inflow of foreign exchange in the country. Thus, sale of machinery to abroad will be recorded as a credit item under visible items in the current account.

7. BOP deficit:

- When a country's payments for autonomous transactions exceed its receipts, the gap is referred to as the BOP deficit. It can be calculated as follows:
- Deficits in BOP occur when the receipts on account of autonomous transactions are fewer than payments on account of autonomous transactions.
- If the home country's receipts are Rs. 500 crore and payments are Rs. 600 crores, the BOP deficit will be calculated 600-500= 100 Crore.
- When a country has a balance of payments deficit, it imports more products, services, and capital than it exports.
- The country has to borrow from other countries in order to pay for its imports..
- In the short run, this contributes to the country's economic growth. It's analogous to taking out a student loan to pay for college, as ultimately college will help in shaping the future of the student.

8. How is the exchange rate determined under a flexible exchange rate regime?

Under flexible exchange rate regime, the rate of exchange is determined by the forces of demand and supply. In other words, the equilibrium rate of exchange occurs where demand and supply are equal to each other. This can be illustrated with the help of the given figure:



In the figure, x−axis represents demand for and supply of foreign currency and y−axis represents theexchange rate. DD is the demand curve that is downward slopping, showing an inverse relationship between the rate of exchange and demand for foreign currency. Whereas, the supply curve is upward sloping, showing positive relationship between the rate of exchange and the supply of foreign currency. E is the equilibrium rate of exchange, where the demand equates the supply of foreign exchange (OR). Now, if the exchange rate rises to OR_1, then the supply exceeds the demand, forcing the exchange rate to fall back to OR. On the contrary, if the exchange rate falls to OR_2, there is excess demand over supply. Hence, the rate of exchange rises from R_2 to R. Hence, the equilibrium exchange rate (OR) is determined by demand and supply of foreigncurrency

9. Where is 'borrowings from abroad' recorded in the Balance of Payments Accounts? Give reasons.

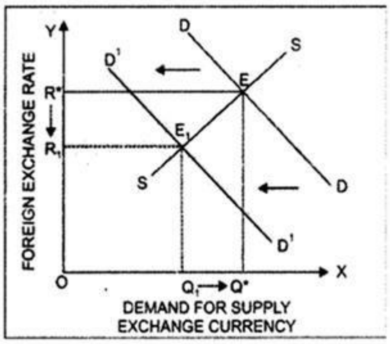
Borrowings from abroad would lead to an inflow of foreign exchange into the country. Thus, borrowings from abroad will be recorded as positive items in the capital account of Balance of Payments.

10. "Indian Rupee (₹) plunged to all time low of ₹ 74.48 against the US Dollar ($)". In the light of the above report, discuss the impact of the situation on Indian Imports.

Indian rupee plunged to all time low of rupees ₹ 74.4 8 against US Dollar. This is called as depreciation in the value of Indian rupee. It might lead to fall in imports as foreign goods will become more expensive for domestic consumers.

11. Recently Government of India has doubled the import duty on gold. What impact is it likely to have on foreign exchange rate and how?

When the import duty on gold rises, the import of gold would become costlier. This would reduce the demand for foreign currency. Since the supply of foreign currency remains the same, the foreign exchange rate would fall. This implies appreciation of rupees.



In the diagram, point E determines the equilibrium exchange rate in the foreign market (R*) and equilibrium quantity (Q*) of the foreign currency, where demand (DD) and supply (SS) curves intersect. A fall in the demand for foreign currency will cause the demand curve to shift-to the left from DD to D_1D_1, and the exchange rate falls to R_1 New equilibrium is established at E_1.

12. How does giving incentives for exports influence foreign exchange rate? Explain.

The incentives for exports boost exports of the country. An increase in exports causes thesupply of foreign currency to increase in the domestic country while the demand remains unchanged. Consequently, the exchange rate falls and the domestic currency appreciates.in the diagram, point E determines the equilibrium exchange rate in the foreign market (R*)and equilibrium quantity (0*) of the foreign currency, where demand (DD) and supply (SS) curves intersect. A rise in the supply for foreign currency will cause the supplycurve to shift to the right from SS to S_1 S_1 and the exchange rate falls to R_1.