Chapter 24
Monetary and Fiscal Policy in the ISLM Model

Multiple Choice

1) Other things equal, a decrease in autonomous consumption shifts the _____ curve to the _____.
   (a) IS; right
   (b) IS; left
   (c) LM; left
   (d) LM; right
   Answer: B
   Question Status: Previous Edition

2) In the Keynesian cross diagram, a decline in autonomous consumer expenditure causes the aggregate demand function to shift _____ and the equilibrium level of aggregate output to _____.
   (a) up; rise
   (b) up; fall
   (c) down; rise
   (d) down; fall
   Answer: D
   Question Status: Previous Edition

3) In the Keynesian cross diagram, an increase in autonomous consumer expenditure causes the aggregate demand function to shift _____ and the equilibrium level of aggregate output to _____.
   (a) up; rise
   (b) up; fall
   (c) down; rise
   (d) down; fall
   Answer: A
   Question Status: Previous Edition

4) In the Keynesian cross diagram, an increase in autonomous consumer expenditure causes the aggregate demand function to shift _____, the equilibrium level of aggregate output to rise, and the IS curve to shift to the _____.
   (a) up; left
   (b) up; right
   (c) down; left
   (d) down; right
   Answer: B
   Question Status: Previous Edition
5) In the Keynesian cross diagram, a decline in autonomous consumer expenditure causes the aggregate demand function to shift _____, the equilibrium level of aggregate output to fall, and the IS curve to shift to the _____.
   (a) up; left
   (b) up; right
   (c) down; left
   (d) down; right
   Answer: C
   Question Status: Previous Edition

6) In the Keynesian cross diagram, a decline in autonomous consumer expenditure causes the aggregate demand function to shift down, the equilibrium level of aggregate output to _____, and the IS curve to shift to the _____.
   (a) rise; left
   (b) rise; right
   (c) fall; left
   (d) fall; right
   Answer: C
   Question Status: Previous Edition

7) In the Keynesian cross diagram, an increase in autonomous consumer expenditure causes the aggregate demand function to shift up, the equilibrium level of aggregate output to _____, and the IS curve to shift to the _____.
   (a) rise; left
   (b) rise; right
   (c) fall; left
   (d) fall; right
   Answer: B
   Question Status: Previous Edition

8) An increase in autonomous consumer expenditure causes the equilibrium level of aggregate output to _____ at any given interest rate and shifts the _____ curve to the _____.
   (a) rise; LM; right
   (b) rise; IS; right
   (c) fall; LM; left
   (d) rise; IS; left
   (e) fall; IS; right
   Answer: B
   Question Status: Previous Edition
9) A decrease in autonomous consumer expenditure causes the equilibrium level of aggregate output to _____ at any given interest rate and shifts the _____ curve to the _____.
   (a) rise; LM; right
   (b) rise; IS; right
   (c) fall; IS; left
   (d) rise; LM; left
   (e) fall; IS; right
   Answer: C
   Question Status: Previous Edition

10) Changes in the interest rate affect planned investment spending and hence the equilibrium level of output,
   (a) but this change in investment spending merely causes a movement along the IS curve and not a shift.
   (b) but this change in investment spending is crowded out by higher taxes.
   (c) but this change in investment spending is crowded out by higher government spending.
   (d) but this change in investment spending is crowded out by lower consumer expenditures.
   Answer: A
   Question Status: Previous Edition

11) A rise in planned investment spending unrelated to the interest rate causes the equilibrium level of aggregate output to _____ and shifts the _____ curve to the _____.
   (a) rise; LM; right
   (b) rise; IS; right
   (c) fall; IS; left
   (d) rise; LM; left
   Answer: B
   Question Status: Previous Edition

12) A decline in planned investment spending unrelated to the interest rate causes the equilibrium level of aggregate output to _____ and shifts the _____ curve to the _____.
   (a) rise; LM; right
   (b) rise; IS; right
   (c) fall; IS; left
   (d) rise; LM; left
   Answer: C
   Question Status: Previous Edition

13) In the Keynesian cross diagram, a decrease in investment spending because companies become more pessimistic about investment profitability causes the aggregate demand function to shift _____ and the equilibrium level of aggregate output to _____.
   (a) up; rise
   (b) up; fall
   (c) down; rise
   (d) down; fall
   Answer: D
   Question Status: Previous Edition
14) In the Keynesian cross diagram, an increase in investment spending because companies become more optimistic about investment profitability causes the aggregate demand function to shift _____ and the equilibrium level of aggregate output to _____.
   (a) up; rise
   (b) up; fall
   (c) down; rise
   (d) down; fall
   Answer: A
   Question Status: Previous Edition

15) In the Keynesian cross diagram, an increase in investment spending because companies become more optimistic about investment profitability causes the aggregate demand function to shift ____, the equilibrium level of aggregate output to rise, and the IS curve to shift to the _____.
   (a) up; left
   (b) up; right
   (c) down; left
   (d) down; right
   Answer: B
   Question Status: Previous Edition

16) In the Keynesian cross diagram, a decrease in investment spending because companies become more pessimistic about investment profitability causes the aggregate demand function to shift ____, the equilibrium level of aggregate output to fall, and the IS curve to shift to the _____.
   (a) up; left
   (b) up; right
   (c) down; left
   (d) down; right
   Answer: C
   Question Status: Previous Edition

17) In the Keynesian cross diagram, a decrease in investment spending because companies become more pessimistic about investment profitability causes the aggregate demand function to shift down, the equilibrium level of aggregate output to ____, and the IS curve to shift to the _____.
   (a) rise; left
   (b) rise; right
   (c) fall; left
   (d) fall; right
   Answer: C
   Question Status: Previous Edition
18) In the Keynesian cross diagram, an increase in investment spending because companies become more optimistic about investment profitability causes the aggregate demand function to shift up, the equilibrium level of aggregate output to ______, and the IS curve to shift to the ______.
   (a) rise; left
   (b) rise; right
   (c) fall; left
   (d) fall; right
   Answer: B
   Question Status: Previous Edition

19) A decrease in fully autonomous investment, other things equal, shifts the _____ curve to the _____.
   (a) IS; right
   (b) IS; left
   (c) LM; left
   (d) LM; right
   Answer: B
   Question Status: Previous Edition

20) In the ISLM framework, the decrease in investment spending believed by Keynes to be the cause of the Great Depression would be illustrated by a shift of the _____ curve to the _____.
   (a) IS; right
   (b) IS; left
   (c) LM; left
   (d) LM; right
   Answer: B
   Question Status: Previous Edition

21) An increase in government spending causes the equilibrium level of aggregate output to ______ at any given interest rate and shifts the _____ curve to the _____.
   (a) rise; LM; right
   (b) rise; LM; left
   (c) fall; IS; left
   (d) fall; LM; left
   (e) rise; IS; right
   Answer: E
   Question Status: Revised

22) A reduction in government spending causes the equilibrium level of aggregate output to ______ at any given interest rate and shifts the _____ curve to the _____.
   (a) fall; LM; right
   (b) fall; IS; left
   (c) fall; LM; left
   (d) rise; LM; right
   Answer: B
   Question Status: Previous Edition
23) Increases in government spending increase interest rates and aggregate output. In the ISLM framework, this is a _____ shift of the _____ curve.
   (a) leftward; LM
   (b) rightward; LM
   (c) leftward; IS
   (d) rightward; IS
   (e) leftward; AD
   Answer: D
   Question Status: Study Guide

24) The IS curve shifts to the left when
   (a) taxes increase.
   (b) government spending increases.
   (c) the money supply increases.
   (d) all of the above occur.
   (e) both (a) and (b) of the above occur.
   Answer: A
   Question Status: Study Guide

25) A decline in taxes _____ consumer expenditure and shifts the _____ curve shifts to the _____.
   (a) raises; LM; right
   (b) lowers; IS; left
   (c) raises; IS; right
   (d) lowers; LM; left
   Answer: C
   Question Status: Revised

26) A tax increase ______ disposable income, ______ consumption expenditure, and shifts the IS curve to the _____.
   (a) increases; increases; right
   (b) increases; decreases; left
   (c) decreases; increases; left
   (d) decreases; decreases; right
   (e) decreases; decreases; left
   Answer: E
   Question Status: New

27) A tax cut ______ disposable income, ______ consumption expenditure, and shifts the IS curve to the _____.
   (a) increases; increases; right
   (b) increases; decreases; left
   (c) decreases; increases; left
   (d) decreases; decreases; right
   (e) decreases; decreases; left
   Answer: A
   Question Status: New
28) A tax cut
(a) increases consumption expenditure by reducing disposable income, thereby shifting the IS curve to the right.
(b) increases consumption expenditure by increasing disposable income, thereby shifting the LM curve to the right.
(c) increases consumption expenditure by increasing disposable income, thereby shifting the IS curve to the right.
(d) decreases consumption expenditure by reducing disposable income, thereby shifting the LM curve to the right.
(e) decreases consumption expenditure by reducing disposable income, thereby shifting the IS curve to the left.
Answer: C
Question Status: New

29) A tax increase shifts the IS curve to the
(a) left, causing output and interest rates to fall.
(b) left, causing output and interest rates to increase.
(c) right, causing output and interest rates to fall.
(d) right, causing output and interest rates to rise.
(e) left, causing output to fall and interest rates to increase.
Answer: A
Question Status: New

30) In 1981, Congress and President Reagan passed legislation cutting taxes and increasing federal expenditures. This policy shifted the ____ curve to the _____.
(a) LM; left
(b) LM; right
(c) IS; right
(d) IS; left
(e) AD; left
Answer: C
Question Status: Study Guide

31) If American college students decide that drinking Mexican-brewed beer helps one get noticed, net exports will tend to fall causing the _____ curve to shift to the left and aggregate demand to _____.
(a) LM; fall
(b) IS; fall
(c) LM; rise
(d) IS; rise
Answer: B
Question Status: Previous Edition
32) If young business professionals in America suddenly decide that driving German-made cars is an important status symbol, net exports will tend to _____ causing aggregate demand to _____.
(a) fall; fall
(b) fall; rise
(c) rise; fall
(d) rise; rise
Answer: A
Question Status: Previous Edition

33) An autonomous decline in the value of the American dollar makes American goods _____ relative to foreign goods and results in a _____ in net exports.
(a) cheaper; decline
(b) cheaper; rise
(c) dearer; decline
(d) dearer; rise
Answer: B
Question Status: Previous Edition

34) An autonomous rise in the value of the dollar makes American goods _____ expensive relative to foreign goods which _____ net exports.
(a) less; decreases
(b) less; increases
(c) more; decreases
(d) more; increases
Answer: C
Question Status: Previous Edition

35) When the value of the dollar rises, American goods become _____ expensive relative to foreign goods, which _____ exports.
(a) more; increases
(b) less; increases
(c) more; decreases
(d) less; decreases
Answer: C
Question Status: Previous Edition

36) A shift in tastes toward foreign goods _____ net exports and causes the quantity of aggregate output demanded to _____.
(a) decreases; rise
(b) decreases; fall
(c) increases; rise
(d) increases; fall
Answer: B
Question Status: Previous Edition
37) A shift in tastes toward American goods _____ net exports and causes the quantity of aggregate output demanded to _____.
(a) decreases; rise
(b) decreases; fall
(c) increases; rise
(d) increases; fall
Answer: C
Question Status: Previous Edition

38) A shift in tastes toward American goods _____ net exports and causes the IS curve to shift to the _____.
(a) decreases; right
(b) decreases; left
(c) increases; right
(d) increases; left
Answer: C
Question Status: Previous Edition

39) A shift in tastes toward foreign goods _____ net exports and causes the IS curve to shift to the _____.
(a) decreases; right
(b) decreases; left
(c) increases; right
(d) increases; left
Answer: B
Question Status: Previous Edition

40) A decline in the value of the dollar makes American goods cheaper relative to foreign goods, resulting in a _____ in net exports and a _____ shift of the IS curve.
(a) fall; leftward
(b) rise; leftward
(c) fall; rightward
(d) rise; rightward
Answer: D
Question Status: Previous Edition

41) An increase in the value of the dollar makes foreign goods cheaper relative to American goods, resulting in a _____ in net exports and a _____ shift of the IS curve.
(a) fall; leftward
(b) rise; leftward
(c) fall; rightward
(d) rise; rightward
Answer: A
Question Status: Previous Edition
42) Factors that cause the IS curve to shift include
   (a) changes in autonomous consumer spending.
   (b) changes in government spending.
   (c) changes in investment spending related to business confidence.
   (d) all of the above.
   Answer: D
   Question Status: Previous Edition

43) Factors that cause the IS curve to shift include
   (a) changes in autonomous consumer spending.
   (b) changes in government spending.
   (c) changes in investment spending related to a change in the interest rate.
   (d) only (a) and (b) of the above.
   Answer: D
   Question Status: Previous Edition

44) Factors that cause the IS curve to shift include
   (a) changes in autonomous consumer spending.
   (b) changes in taxes.
   (c) changes in government spending.
   (d) all of the above.
   (e) only (a) and (b) of the above.
   Answer: D
   Question Status: Previous Edition

45) Factors that cause the IS curve to shift include
   (a) changes in autonomous consumer spending.
   (b) changes in taxes.
   (c) changes in the money supply.
   (d) all of the above.
   (e) only (a) and (b) of the above.
   Answer: E
   Question Status: Previous Edition

46) Factors that cause the IS curve to shift include
   (a) changes in autonomous consumer spending.
   (b) changes in the money supply.
   (c) changes in investment spending related to a change in the interest rate.
   (d) only (a) and (b) of the above.
   Answer: A
   Question Status: Previous Edition
47) Factors that cause the IS curve to shift include
(a) changes in interest rates.
(b) changes in the money supply.
(c) changes in investment spending related to business confidence.
(d) all of the above.
Answer: C
Question Status: Previous Edition

48) Factors that cause the IS curve to shift include
(a) changes in the money supply.
(b) changes in government spending.
(c) changes in interest rates.
(d) only (a) and (b) of the above.
Answer: B
Question Status: Previous Edition

49) Which of the following does not shift the IS curve?
(a) An increase in autonomous consumption
(b) An increase in government spending
(c) A decline in government spending
(d) A fall in the interest rate
Answer: D
Question Status: Previous Edition

50) An increase in the money supply, other things equal, shifts the _____ curve to the _____.
(a) IS; right
(b) IS; left
(c) LM; left
(d) LM; right
Answer: D
Question Status: Previous Edition

51) If the Federal Reserve conducts open market purchases, the money supply _____, shifting the LM curve to the _____.
(a) decreases; right
(b) decreases; left
(c) increases; right
(d) increases; left
Answer: C
Question Status: Previous Edition
52) If the Federal Reserve conducts open market sales, the money supply _____, shifting the LM curve to the _____.
   (a) decreases; right
   (b) decreases; left
   (c) increases; right
   (d) increases; left
   Answer: B
   Question Status: Previous Edition

53) If the Federal Reserve conducts open market _____, the money supply _____, shifting the LM curve to the right.
   (a) purchases; decreases
   (b) sales; decreases
   (c) purchases; increases
   (d) sales; increases
   Answer: C
   Question Status: Previous Edition

54) If the Federal Reserve conducts open market _____, the money supply _____, shifting the LM curve to the left.
   (a) purchases; decreases
   (b) sales; decreases
   (c) purchases; increases
   (d) sales; increases
   Answer: B
   Question Status: Previous Edition

55) An increase in the quantity of money supplied shifts the money supply curve to the _____, and the equilibrium interest rate _____.
   (a) right; falls
   (b) right; rises
   (c) left; falls
   (d) left; rises
   Answer: A
   Question Status: Previous Edition

56) A decrease in the quantity of money supplied shifts the money supply curve to the _____, and the equilibrium interest rate _____.
   (a) right; falls
   (b) right; rises
   (c) left; falls
   (d) left; rises
   Answer: D
   Question Status: Previous Edition
57) An increase in the quantity of money supplied shifts the money supply curve to the _____ and the LM curve to the _____.
   (a) right; left
   (b) right; right
   (c) left; left
   (d) left; right
   Answer: B
   Question Status: Previous Edition

58) A decrease in the quantity of money supplied shifts the money supply curve to the _____, and the LM curve to the _____.
   (a) right; left
   (b) right; right
   (c) left; left
   (d) left; right
   Answer: C
   Question Status: Previous Edition

59) A decline in the money _____ shifts the LM curve to the _____, causing the interest rate to rise and output to fall.
   (a) demand; right
   (b) demand; left
   (c) supply; right
   (d) supply; left
   Answer: D
   Question Status: Previous Edition

60) A decline in the money supply shifts the LM curve to the left, causing the interest rate to _____ and output to _____.
   (a) rise; rise
   (b) rise; fall
   (c) fall; rise
   (d) fall; fall
   Answer: B
   Question Status: Previous Edition

61) An increase in the money _____ shifts the LM curve to the _____, causing the interest rate to fall and output to rise.
   (a) demand; right
   (b) demand; left
   (c) supply; right
   (d) supply; left
   Answer: C
   Question Status: Previous Edition
62) An increase in the money supply shifts the LM curve to the right, causing the interest rate to _____ and output to _____.
(a) rise; rise
(b) rise; fall
(c) fall; rise
(d) fall; fall
Answer: C
Question Status: Previous Edition

63) When the central bank _____ the money supply, the LM curve shifts to the _____, interest rates _____, and equilibrium aggregate output _____.
(a) increases; right; fall; increases
(b) increases; left; rise; decreases
(c) decreases; left; rise; increases
(d) decreases; left; fall; increases
Answer: A
Question Status: Previous Edition

64) During the early years of the Great Depression there was a significant decrease in the money supply that caused the _____ to shift _____.
(a) IS; leftward
(b) IS; rightward
(c) LM; leftward
(d) LM; rightward
(e) AD; rightward
Answer: C
Question Status: Study Guide

65) A decrease in money demand, other things equal, shifts the _____ curve to the _____.
(a) IS; right
(b) IS; left
(c) LM; left
(d) LM; right
Answer: D
Question Status: Previous Edition

66) An increase in money demand, other things equal, shifts the _____ curve to the _____.
(a) IS; right
(b) IS; left
(c) LM; left
(d) LM; right
Answer: C
Question Status: Previous Edition
67) An autonomous increase in money demand
   (a) shifts the IS curve to the right.
   (b) shifts the IS curve to the left.
   (c) shifts the LM curve to the right.
   (d) shifts the LM curve to the left.
   (e) has no effect on the IS or LM curves.
   Answer: D
   Question Status: New

68) An autonomous increase in money demand
   (a) shifts the LM curve to the left, increasing interest rates and real output.
   (b) shifts the LM curve to the left, increasing interest rates and decreasing real output.
   (c) shifts the LM curve to the right, decreasing interest rates and real output.
   (d) shifts the LM curve to the right, decreasing interest rates and increasing real output.
   (e) does not affect the LM curve.
   Answer: B
   Question Status: New

69) If the demand for money increases relative to the supply of money
   (a) interest rates will trend upward.
   (b) interest rates will trend downward.
   (c) interest rates are not affected by increases in money demand.
   (d) interest rates will behave randomly.
   (e) the impact on interest rates cannot be determined.
   Answer: A
   Question Status: New

70) As bonds become a riskier asset, the demand for money _____ and, all else constant, the equilibrium interest rate _____.
   (a) rises; rises
   (b) rises; falls
   (c) falls; rises
   (d) falls; falls
   Answer: A
   Question Status: Previous Edition

71) An autonomous rise in _____ (not caused by a change in the price level, aggregate output, or the interest rate) shifts the _____ curve to the _____.
   (a) net exports; LM; right
   (b) net exports; LM; left
   (c) money demand; IS; right
   (d) money demand; LM; right
   (e) money demand; LM; left
   Answer: E
   Question Status: Revised
72) In the ISLM framework, an expansionary monetary policy causes aggregate output to _____ and the interest rate to _____.
   (a) increase; increase
   (b) increase; decrease
   (c) decrease; decrease
   (d) decrease; increase
   Answer: B
   Question Status: Previous Edition

73) An expansionary monetary policy
   (a) shifts the LM curve to the left, reducing output and increasing interest rates.
   (b) shifts the LM curve to the left, reducing both real output and interest rates.
   (c) shifts the LM curve to the right, reducing both interest rates and real output.
   (d) shifts the LM curve to the right; reducing interest rates and increasing real output.
   (e) does not shift the LM curve.
   Answer: D
   Question Status: New

74) An expansionary monetary policy
   (a) reduces interest rates.
   (b) increases real output.
   (c) shifts the LM curve to the right.
   (d) all of the above.
   (e) both (a) and (b) of the above.
   Answer: D
   Question Status: New

75) A monetary expansion is characterized by
   (a) rising output and interest rates.
   (b) rising output and falling interest rates.
   (c) constant output and falling interest rates.
   (d) falling output and interest rates.
   (e) falling output and rising interest rates.
   Answer: B
   Question Status: New

76) A contractionary monetary policy
   (a) shifts the LM curve to the left, reducing output and increasing interest rates.
   (b) shifts the LM curve to the left, reducing both real output and interest rates.
   (c) shifts the LM curve to the right, reducing both interest rates and real output.
   (d) shifts the LM curve to the right; reducing interest rates and increasing real output.
   (e) does not shift the LM curve.
   Answer: A
   Question Status: New
77) A contractionary monetary policy
   (a) reduces interest rates.
   (b) reduces real output.
   (c) shifts the LM curve to the right.
   (d) all of the above.
   (e) both (a) and (b) of the above.
   Answer: B

78) In the money market, a condition of excess demand for money can be eliminated by a _____ in aggregate output or a _____ in the interest rate, both of which reduce the quantity of money demanded.
   (a) rise; rise
   (b) rise; fall
   (c) fall; rise
   (d) fall; fall
   Answer: C

79) In the money market, a condition of excess supply of money can be eliminated by a _____ in aggregate output or a _____ in the interest rate, both of which increase the quantity of money demanded.
   (a) rise; rise
   (b) rise; fall
   (c) fall; rise
   (d) fall; fall
   Answer: B

80) In the ISLM framework, an expansionary fiscal policy causes aggregate output to _____ and the interest rate to _____.
   (a) increase; increase
   (b) increase; decrease
   (c) decrease; decrease
   (d) decrease; increase
   Answer: A

81) In the ISLM framework, a contractionary fiscal policy causes aggregate output to _____ and the interest rate to _____.
   (a) increase; increase
   (b) increase; decrease
   (c) decrease; decrease
   (d) decrease; increase
   Answer: C
82) In the case of an expansionary _____ policy, the interest rate rises, while in the case of an expansionary _____ policy, the interest rate falls.
   (a) monetary; monetary  
   (b) monetary; fiscal  
   (c) fiscal; monetary  
   (d) fiscal; fiscal  
   Answer: C
   Question Status: Previous Edition

83) Aggregate output and the interest rate are _____ related to government spending and are _____ related to taxes.
   (a) positively; positively  
   (b) positively; negatively  
   (c) negatively; positively  
   (d) negatively; negatively  
   Answer: B
   Question Status: Revised

84) An increase in spending that results from expansionary _____ policy causes the interest rate to _____.
   (a) fiscal; rise  
   (b) fiscal; fall  
   (c) incomes; rise  
   (d) incomes; fall  
   Answer: A
   Question Status: Previous Edition

85) Despite an expansionary monetary policy, an economy experiences a recession. The recession could occur in spite of the rightward shift of the LM curve if
   (a) the IS curve shifts leftward.  
   (b) the IS curve shifts rightward.  
   (c) the money supply increases.  
   (d) taxes are cut.  
   (e) there is an investment boom.  
   Answer: A
   Question Status: Study Guide

86) If an economy experiences high interest rates and high unemployment, the ISLM framework predicts that _____ policy has been too _____.
   (a) fiscal; expansionary  
   (b) fiscal; contractionary  
   (c) monetary; expansionary  
   (d) monetary; contractionary  
   (e) exchange-rate; expansionary  
   Answer: D
   Question Status: Study Guide
87) Which of the following statements concerning Keynesian ISLM analysis are true?
(a) For a given change in taxes, the IS curve will shift less than for an equal change in government spending.
(b) Changes in net exports arising from a change in interest rates merely causes a movement along the IS curve and not a shift.
(c) A rise in the money supply shifts the LM curve to the right.
(d) All of the above.
Answer: D
Question Status: Previous Edition

88) Which of the following statements concerning Keynesian ISLM analysis are true?
(a) For a given change in taxes, the IS curve will shift less than for an equal change in government spending.
(b) An increase in net exports arising from a reduction in interest rates causes the IS curve to shift rightward.
(c) A rise in the money supply shifts the LM curve to the left.
(d) Only (a) and (b) of the above.
Answer: A
Question Status: Revised

89) In Figure 24-1, the economy moves from point 1 to point 2 whenever
(a) government spending increases.
(b) investment expenditures unrelated to the interest rate increase.
(c) the money supply increases.
(d) either (a) or (b) occurs.
Answer: D
Question Status: Previous Edition
90) In Figure 24-1, the economy moves from point 1 to point 2 whenever
(a) government spending increases.
(b) investment expenditures unrelated to the interest rate increase.
(c) taxes are reduced.
(d) any of the above occur.
(e) either (a) or (b) occurs.
Answer: D
Question Status: Previous Edition

91) In Figure 24-1, the economy moves from point 1 to point 2 whenever
(a) government spending increases.
(b) the money supply increases.
(c) taxes are increased.
(d) either (a) or (b) occurs.
Answer: A
Question Status: Previous Edition

92) In Figure 24-1, the economy moves from point 1 to point 4 whenever
(a) government spending increases.
(b) the money supply increases.
(c) taxes are increased.
(d) either (a) or (b) occurs.
Answer: B
Question Status: Previous Edition

93) In Figure 24-1, the economy moves from point 2 to point 3 whenever
(a) government spending increases.
(b) the money supply increases.
(c) taxes are increased.
(d) either (a) or (b) occurs.
Answer: B
Question Status: Previous Edition

94) In Figure 24-1, the economy moves from point 3 to point 2 whenever
(a) government spending declines.
(b) taxes are increased.
(c) the money supply declines.
(d) either (a) or (b) occurs.
Answer: C
Question Status: Previous Edition
95) In Figure 24-1, the economy moves from point 3 to point 4 whenever
(a) government spending declines.
(b) taxes are increased.
(c) the money supply declines.
(d) any of the above occur.
(e) either (a) or (b) occurs.
Answer: E
Question Status: Previous Edition

96) In Figure 24-1, the economy moves from point 2 to point 1 whenever
(a) government spending declines.
(b) taxes are increased.
(c) investment expenditures unrelated to the interest rate decrease.
(d) any of the above occur.
Answer: D
Question Status: Previous Edition

97) In Figure 24-1, the economy moves from point 4 to point 3 whenever
(a) government spending increases.
(b) investment expenditures unrelated to the interest rate increase.
(c) the money supply increases.
(d) either (a) or (b) occurs.
Answer: D
Question Status: Previous Edition

98) In Figure 24-1, the economy moves from point 4 to point 3 whenever
(a) government spending increases.
(b) investment expenditures unrelated to the interest rate increase.
(c) taxes are reduced.
(d) any of the above occur.
Answer: D
Question Status: Previous Edition

99) In Figure 24-1, the economy moves from point 1 to point 3 whenever
(a) both government spending and the money supply increase.
(b) both taxes and the money supply increase.
(c) both government spending and taxes increase.
(d) either (a) or (b) occurs.
Answer: A
Question Status: Previous Edition
100) In Figure 24-1, the economy moves from point 3 to point 1 whenever
(a) both government spending and the money supply increase.
(b) both taxes and the money supply increase.
(c) both government spending and taxes increase.
(d) both government spending and the money supply decrease.
Answer: D
Question Status: Previous Edition

101) In Figure 24-1, the economy moves from point 2 to point 4 whenever
(a) both government spending and the money supply increase.
(b) both taxes and the money supply increase.
(c) both government spending and taxes increase.
(d) both government spending and the money supply decrease.
Answer: B
Question Status: Previous Edition

102) In Figure 24-1, the economy moves from point 4 to point 2 whenever
(a) both government spending and the money supply increase.
(b) both taxes and the money supply increase.
(c) government spending increases and the money supply declines.
(d) taxes increase and the money supply declines.
Answer: C
Question Status: Previous Edition

103) In Figure 24-1, the economy moves from point 2 to point 4 whenever
(a) government spending increases and the money supply declines.
(b) taxes increase and the money supply declines.
(c) government spending declines and the money supply increases.
(d) both government spending and the money supply decrease.
Answer: C
Question Status: Previous Edition

104) In Figure 24-1, the economy moves from point 4 to point 2 whenever
(a) government spending increases and the money supply increases.
(b) both taxes and the money supply increase.
(c) taxes decrease and the money supply declines.
(d) taxes increase and the money supply declines.
Answer: C
Question Status: Previous Edition
105) In Figure 24-2, the economy moves from point 3 to point 1 whenever
(a) government spending increases.
(b) investment expenditures unrelated to the interest rate increase.
(c) the money supply increases.
(d) either (a) or (b) occur.
Answer: C
Question Status: Previous Edition

106) In Figure 24-2, the economy moves from point 3 to point 2 whenever
(a) government spending increases.
(b) investment expenditures unrelated to the interest rate increase.
(c) taxes are reduced.
(d) any of the above occur.
(e) either (a) or (b) occurs.
Answer: D
Question Status: Previous Edition

107) In Figure 24-2, the economy moves from point 4 to point 1 whenever
(a) government spending increases.
(b) the money supply increases.
(c) taxes are increased.
(d) either (a) or (b) occurs.
Answer: C
Question Status: Previous Edition

108) In Figure 24-2, the economy moves from point 1 to point 4 whenever
(a) government spending increases.
(b) the money supply increases.
(c) taxes are increased.
(d) either (a) or (b) occurs.
Answer: A
Question Status: Previous Edition
109) In Figure 24-2, the economy moves from point 2 to point 3 whenever
(a) government spending increases.
(b) the money supply increases.
(c) taxes are increased.
(d) either (a) or (b) occurs.
Answer: C
Question Status: Previous Edition

110) In Figure 24-2, the economy moves from point 1 to point 3 whenever
(a) government spending declines.
(b) taxes are increased.
(c) the money supply declines.
(d) either (a) or (b) occurs.
Answer: C
Question Status: Previous Edition

111) In Figure 24-2, the economy moves from point 4 to point 1 whenever
(a) government spending declines.
(b) taxes are increased.
(c) the money supply declines.
(d) any of the above occur.
(e) either (a) or (b) occurs.
Answer: E
Question Status: Previous Edition

112) In Figure 24-2, the economy moves from point 3 to point 2 whenever
(a) government spending declines.
(b) taxes are decreased.
(c) investment expenditures unrelated to the interest rate decrease.
(d) any of the above occur.
Answer: B
Question Status: Previous Edition

113) In Figure 24-2, the economy moves from point 3 to point 2 whenever
(a) government spending increases.
(b) investment expenditures unrelated to the interest rate increase.
(c) the money supply increases.
(d) either (a) or (b) occurs.
Answer: D
Question Status: Previous Edition
114) In Figure 24-2, the economy moves from point 4 to point 1 whenever
(a) government spending decreases.
(b) investment expenditures unrelated to the interest rate increase.
(c) taxes are reduced.
(d) any of the above occur.
Answer: A
Question Status: Previous Edition

115) In Figure 24-2, the economy moves from point 3 to point 4 whenever
(a) both government spending and the money supply increase.
(b) both taxes and the money supply increase.
(c) both government spending and taxes increase.
(d) either (a) or (b) occurs.
Answer: A
Question Status: Previous Edition

116) In Figure 24-2, the economy moves from point 4 to point 3 whenever
(a) both government spending and the money supply increase.
(b) both taxes and the money supply increase.
(c) both government spending and taxes increase.
(d) both government spending and the money supply decrease.
Answer: D
Question Status: Previous Edition

117) In Figure 24-2, the economy moves from point 1 to point 2 whenever
(a) both government spending and the money supply increase.
(b) both taxes and the money supply increase.
(c) both government spending and taxes increase.
(d) both taxes and the money supply decrease.
Answer: D
Question Status: Previous Edition

118) In Figure 24-2, the economy moves from point 1 to point 2 whenever
(a) both government spending and the money supply increase.
(b) both taxes and the money supply increase.
(c) government spending increases and the money supply declines.
(d) taxes increase and the money supply declines.
Answer: C
Question Status: Previous Edition

119) In Figure 24-2, the economy moves from point 4 to point 3 whenever
(a) government spending increases and the money supply declines.
(b) taxes increase and the money supply declines.
(c) government spending declines and the money supply increases.
(d) both government spending and the money supply increase.
Answer: B
Question Status: Revised
120) In Figure 24-2, the economy moves from point 1 to point 2 whenever
(a) government spending increases and the money supply increases.
(b) both taxes and the money supply increase.
(c) government spending increases and the money supply declines.
(d) taxes increase and the money supply declines.
Answer: C
Question Status: Previous Edition

121) If the quantity of money demanded is not affected by changes in the interest rate, the LM curve
is _____ and fiscal policy will be _____.
(a) horizontal; very effective
(b) horizontal; ineffective
(c) vertical; ineffective
(d) vertical; very effective
Answer: C
Question Status: Previous Edition

122) The LM curve will be vertical and fiscal policy ineffective when
(a) the demand for money is unaffected by changes in the interest rate.
(b) the demand for money is unaffected by changes in the income.
(c) investment is unaffected by changes in the interest rate.
(d) investment is unaffected by changes in the income.
Answer: A
Question Status: Previous Edition

123) The situation in which expansionary fiscal policy does not lead to a rise in aggregate output is
referred to as
(a) fiscal neutrality.
(b) a recession.
(c) complete crowding out.
(d) inflation.
Answer: C
Question Status: Previous Edition

124) Crowding out will be more pronounced the closer to vertical is
(a) the IS curve.
(b) the LM curve.
(c) the consumption function.
(d) none of the above.
Answer: B
Question Status: Previous Edition
125) The less interest-sensitive is money demand,
   (a) the more effective is fiscal policy relative to monetary policy.
   (b) the more effective is monetary policy relative to fiscal policy.
   (c) the steeper is the IS curve.
   (d) the flatter is the LM curve.
   Answer: B

126) The less interest sensitive is money demand, the more effective is _____ policy relative to _____ policy.
   (a) monetary; monetary
   (b) monetary; fiscal
   (c) fiscal; monetary
   (d) fiscal; fiscal
   Answer: B

127) The _____ the demand for money to interest rates, the _____ effective is _____ policy.
   (a) more; more; fiscal
   (b) more; less; fiscal
   (c) less; more; fiscal
   (d) more; more; monetary
   (e) less; less; monetary
   Answer: A

128) If the economy is characterized by a certain and stable LM curve, then
   (a) an interest rate target produces smaller fluctuations in aggregate output.
   (b) a money supply target produces smaller fluctuations in aggregate output.
   (c) a money supply target produces larger fluctuations in aggregate output.
   (d) none of the above.
   Answer: B

129) If the economy is characterized by a stable IS curve and an unstable LM curve, then
   (a) an interest rate target produces smaller fluctuations in aggregate output.
   (b) a money supply target produces smaller fluctuations in aggregate output.
   (c) a money supply target produces larger fluctuations in aggregate output.
   (d) both (a) and (c) of the above will be true.
   (e) both (b) and (c) of the above will be true.
   Answer: D
130) If the _____ curve is relatively more unstable than the _____ curve, a money supply target is preferred.
   (a) IS; IS
   (b) IS; LM
   (c) LM; IS
   (d) LM; LM
   Answer: B
   Question Status: Revised

131) If the _____ curve is relatively more unstable than the _____ curve, an interest rate target is preferred.
   (a) IS; IS
   (b) IS; LM
   (c) LM; IS
   (d) LM; LM
   Answer: C
   Question Status: Revised

132) If the Fed adopts a policy of pegging the interest rate, a _____ in government spending forces the Fed to _____ the money supply to prevent interest rates from ______.
   (a) fall; increase; increasing
   (b) fall; increase; decreasing
   (c) fall; decrease; increasing
   (d) rise; increase; increasing
   (e) rise; increase; decreasing
   Answer: D
   Question Status: Study Guide

133) The rate of output at which the price level has no tendency to rise or fall is called the
   (a) natural rate of output.
   (b) potential level of income.
   (c) bliss point.
   (d) efficient level of output.
   Answer: A
   Question Status: Previous Edition

134) In the long-run ISLM model, as long as the level of output _____ the natural rate level, the price level will continue to _____, shifting the LM curve to the _____, until finally output is back at the natural rate level.
   (a) exceeds; rise; right
   (b) exceeds; rise; left
   (c) remains below; fall; left
   (d) remains below; rise; right
   Answer: B
   Question Status: Previous Edition
135) In the long-run ISLM model, as long as the level of output _____ the natural rate level, the price level will continue to _____, shifting the LM curve to the _____, until finally output is back at the natural rate level.
   (a) exceeds; rise; right
   (b) exceeds; fall; left
   (c) remains below; fall; right
   (d) remains below; rise; left
   Answer: C
   Question Status: Previous Edition

136) In the long-run ISLM model, an increase in the money supply leaves the level of output and interest rates unchanged, an outcome called
   (a) interest rate overshooting.
   (b) long-run money neutrality.
   (c) long-run crowding out.
   (d) the long-run Phillips curve.
   Answer: B
   Question Status: Previous Edition

137) In the long-run ISLM model, the long-run effect of an expansionary monetary policy is to
   (a) increase real output and the interest rate.
   (b) decrease real output and the interest rate.
   (c) increase real output and leave the interest rate unchanged.
   (d) increase the interest rate and leave real output unchanged.
   (e) not change either real output or the interest rate.
   Answer: E
   Question Status: New

138) The long-run neutrality of money refers to the fact that in the long run, monetary policy
   (a) changes only real output.
   (b) changes only the real interest rate.
   (c) changes both real output and the real interest rate.
   (d) affects real output only when combined with fiscal policy.
   (e) has no effect on either real output or the real interest rate.
   Answer: E
   Question Status: New

139) In the long-run ISLM model, the long-run effect of an expansionary fiscal policy is to
   (a) increase real output and the interest rate.
   (b) decrease real output and the interest rate.
   (c) increase real output and leave the interest rate unchanged.
   (d) increase the interest rate and leave real output unchanged.
   (e) not change either real output or the interest rate.
   Answer: D
   Question Status: New
140) In the long-run ISLM model, the long-run effect of a contractionary fiscal policy is to
(a) increase real output and the interest rate.
(b) decrease real output and the interest rate.
(c) increase real output and leave the interest rate unchanged.
(d) decrease the interest rate and leave real output unchanged.
(e) not change either real output or the interest rate.
Answer: D
Question Status: New

141) In the long-run ISLM model, the long-run effect of a cut in government spending is to
(a) increase real output and the interest rate.
(b) increase real output and not affect the interest rate.
(c) not affect real output and increase the interest rate.
(d) not affect real output and reduce the interest rate.
(e) not affect either real output or the interest rate.
Answer: D
Question Status: New

142) In the long-run ISLM model, the long-run effect of a tax cut is to
(a) increase real output and the interest rate.
(b) increase real output and not affect the interest rate.
(c) not affect real output and increase the interest rate.
(d) not affect real output and reduce the interest rate.
(e) not affect either real output or the interest rate.
Answer: C
Question Status: New

143) In the long-run ISLM model, the long-run effect of an autonomous increase in investment is to
(a) increase real output and the interest rate.
(b) increase real output and not affect the interest rate.
(c) not affect real output and increase the interest rate.
(d) not affect real output and reduce the interest rate.
(e) not affect either real output or the interest rate.
Answer: C
Question Status: New

144) In the long-run ISLM model, the long-run effect of a fall in net exports is to
(a) increase real output and the interest rate.
(b) increase real output and not affect the interest rate.
(c) not affect real output and increase the interest rate.
(d) not affect real output and reduce the interest rate.
(e) not affect either real output or the interest rate.
Answer: D
Question Status: New
145) In the long-run ISLM model, the long-run effect of an autonomous fall in consumption expenditure is to
(a) increase real output and the interest rate.
(b) increase real output and not affect the interest rate.
(c) not affect real output and increase the interest rate.
(d) not affect real output and reduce the interest rate.
(e) not affect either real output or the interest rate.
Answer: D
Question Status: New

146) In the long-run the ISLM model predicts that
(a) only monetary policy can change real output.
(b) only fiscal policy can change real output.
(c) both monetary and fiscal policy can change real output.
(d) monetary and fiscal policies change real output only when used together.
(e) neither monetary nor fiscal policy can change real output.
Answer: E
Question Status: New

147) In the long run there is complete crowding out. This means that
(a) fiscal policy has no effect on real output in the long run.
(b) monetary policy has no effect on real output in the short run.
(c) monetary policy has no effect on real output in the long run.
(d) all of the above are true.
(e) both (a) and (c) of the above.
Answer: E
Question Status: New

148) The relationship between the price level and the quantity of aggregate output for which the goods and money markets are in equilibrium is called
(a) the IS curve.
(b) the LM curve.
(c) the aggregate demand curve.
(d) the production function.
Answer: C
Question Status: Previous Edition

149) If the price level increases, other things equal, the _____ curve shifts to the _____.
(a) IS; right
(b) IS; left
(c) LM; left
(d) LM; right
Answer: C
Question Status: Previous Edition
150) Other things equal, a decrease in the price level will
(a) move the economy down a given aggregate demand curve.
(b) move the economy up a given aggregate demand curve.
(c) shift the aggregate demand curve to the right.
(d) shift the aggregate demand curve to the left.
Answer: A
Question Status: Previous Edition

151) In deriving the aggregate demand curve a _____ in the price level leads to a(n) _____ in the real money supply because the nominal quantity of dollars can purchase _____ goods and services.
(a) decline; increase; more
(b) decline; decrease; more
(c) rise; increase; fewer
(d) rise; decrease; more
Answer: A
Question Status: Previous Edition

152) In deriving the aggregate demand curve a _____ price level _____ the money supply in real terms, raises interest rates, and _____ the equilibrium level of aggregate output.
(a) higher; reduces; raises
(b) higher; reduces; lowers
(c) lower; increases; raises
(d) lower; increases; lowers
Answer: B
Question Status: Previous Edition

153) The aggregate demand curve slopes down and to the right because
(a) a decrease in the price level raises the real money supply, lowering interest rates.
(b) a decrease in the price level raises the real money supply, decreasing output.
(c) a decrease in the price level increases the nominal money supply, lowering interest rates.
(d) an increase in the price level increases the real money supply, lowering interest rates.
(e) an increase in the price level increases the nominal money supply, raising output.
Answer: A
Question Status: Study Guide

154) The aggregate demand curve has the usual downward slope, since a _____ price level _____ the real money supply, raises interest rates, and lowers the equilibrium level of aggregate output.
(a) lower; reduces
(b) lower; increases
(c) higher; reduces
(d) higher; increases
Answer: C
Question Status: Previous Edition
155) The aggregate demand curve has the usual downward slope, since a higher price level reduces the real money supply, _____ interest rates, and _____ the equilibrium level of aggregate output.
   (a) raises; lowers
   (b) raises; raises
   (c) lowers; lowers
   (d) lowers; raises
   Answer: A
   Question Status: Previous Edition

156) Other things being equal, an increase in government spending will
   (a) shift the aggregate demand curve to the right.
   (b) shift the aggregate demand curve to the left.
   (c) move the economy down a fixed aggregate demand curve.
   (d) move the economy up a fixed aggregate demand curve.
   Answer: A
   Question Status: Previous Edition

157) Expansionary monetary policies, all else remaining the same, will
   (a) move the economy down a fixed aggregate demand curve.
   (b) move the economy up a fixed aggregate demand curve.
   (c) shift the aggregate demand curve to the left.
   (d) shift the aggregate demand curve to the right.
   (e) do none of the above.
   Answer: D
   Question Status: Previous Edition

158) Contractionary monetary policies, other things being equal, will
   (a) move the economy down a fixed aggregate demand curve.
   (b) move the economy up a fixed aggregate demand curve.
   (c) shift the aggregate demand curve to the right.
   (d) shift the aggregate demand curve to the left.
   Answer: D
   Question Status: Previous Edition

159) A purchase of government securities by the Fed shifts the aggregate demand curve
   (a) to the right.
   (b) to the left.
   (c) to the left if the price level falls.
   (d) cannot be determined.
   (e) in any possible direction.
   Answer: A
   Question Status: Study Guide
Factors that cause the aggregate demand curve to shift include
(a) changes in autonomous consumer spending.
(b) changes in government spending.
(c) changes in investment spending related to business confidence.
(d) all of the above.
Answer: D
Question Status: Previous Edition

Factors that cause the aggregate demand curve to shift include
(a) changes in autonomous consumer spending.
(b) changes in taxes.
(c) changes in government spending.
(d) all of the above.
(e) only (a) and (b) of the above.
Answer: D
Question Status: Previous Edition

Factors that cause the aggregate demand curve to shift include
(a) changes in autonomous consumer spending.
(b) changes in taxes.
(c) changes in the money supply.
(d) all of the above.
(e) only (a) and (b) of the above.
Answer: D
Question Status: Previous Edition

Factors that cause the aggregate demand curve to shift include
(a) changes in the money supply.
(b) changes in investment spending related to business confidence.
(c) changes in interest rates.
(d) only (a) and (b) of the above.
Answer: D
Question Status: Previous Edition

Factors that cause the aggregate demand curve to shift include
(a) changes in interest rates.
(b) changes in bond prices.
(c) changes in the money supply.
(d) all of the above.
Answer: C
Question Status: Previous Edition
165) Factors that cause the aggregate demand curve to shift include
   (a) changes in bond prices.
   (b) changes in investment spending related to business confidence.
   (c) changes in interest rates.
   (d) only (a) and (b) of the above.
   Answer: B
   Question Status: Previous Edition

Figure 24-3

166) In Figure 24-3, the economy moves from point 1 to point 2 whenever
   (a) government spending increases.
   (b) investment expenditures unrelated to the interest rate increase.
   (c) the money supply increases.
   (d) any of the above occur.
   Answer: D
   Question Status: Previous Edition

167) In Figure 24-3, the economy moves from point 1 to point 2 whenever
   (a) government spending increases.
   (b) investment expenditures unrelated to the interest rate increase.
   (c) taxes increase.
   (d) any of the above occur.
   (e) either (a) or (b) occurs.
   Answer: E
   Question Status: Previous Edition

168) In Figure 24-3, the economy moves from point 1 to point 2 whenever
   (a) government spending declines.
   (b) the money supply increases.
   (c) taxes increase.
   (d) either (a) or (b) occurs.
   Answer: B
   Question Status: Previous Edition
169) In Figure 24-3, the economy moves from point 2 to point 1 whenever
   (a) government spending decreases.
   (b) investment expenditures unrelated to the interest rate increase.
   (c) the money supply increases.
   (d) any of the above occur.
   Answer: A
   Question Status: Previous Edition

170) In Figure 24-3, the economy moves from point 2 to point 1 whenever
   (a) government spending increases.
   (b) investment expenditures unrelated to the interest rate increase.
   (c) taxes increase.
   (d) the money supply increases.
   Answer: C
   Question Status: Previous Edition

171) In Figure 24-3, the economy moves from point 2 to point 1 whenever
   (a) government spending declines.
   (b) taxes increase.
   (c) the nominal supply of money increases.
   (d) either (a) or (b) occurs.
   Answer: D
   Question Status: Previous Edition

172) In Figure 24-3, the economy moves from point 1 to point 3 when
   (a) government spending increases.
   (b) the nominal supply of money increases.
   (c) taxes are increased.
   (d) none of the above occurs.
   Answer: D
   Question Status: Previous Edition

173) In Figure 24-3, the economy moves from point 3 to point 1 when
   (a) government spending increases.
   (b) the nominal supply of money increases.
   (c) the aggregate price level rises.
   (d) any of the above occur.
   Answer: C
   Question Status: Previous Edition

174) In Figure 24-3, the economy moves from point 1 to point 2 whenever
   (a) both government spending and the money supply increase.
   (b) both taxes increase and government spending decreases.
   (c) both taxes increase and the money supply decreases.
   (d) either (a) or (b) occurs.
   Answer: A
   Question Status: Revised
175) In Figure 24-3, the economy moves from point 1 to point 2 whenever
   (a) government spending decreases and taxes increase.
   (b) taxes increase and the money supply falls.
   (c) both government spending and the money supply decline.
   (d) taxes decrease and the money supply increases.
   Answer: D
   Question Status: Revised

176) In Figure 24-3, the economy moves from point 2 to point 1 whenever
   (a) both government spending and the money supply decrease.
   (b) taxes increase and the money supply declines.
   (c) government spending and the money supply increase.
   (d) taxes are cut and the money supply increases.
   (e) either (a) or (b) occurs.
   Answer: E
   Question Status: Revised

Appendix—Algebra of the ISLM Model

177) As the interest sensitivity of money demand increases
   (a) the multiplier term increases.
   (b) fiscal policy has a greater effect on output.
   (c) monetary policy has a smaller effect on output.
   (d) all of the above.
   (e) both (a) and (b) of the above.
   Answer: D
   Question Status: New

178) As the interest sensitivity of investment spending increases,
   (a) monetary policy has a larger effect on output.
   (b) fiscal policy has a larger effect on output.
   (c) the multiplier increases.
   (d) all of the above.
   (e) both (a) and (b) of the above.
   Answer: A
   Question Status: New

179) An autonomous increase in the value of the domestic exchange rate
   (a) increases output, net exports, and the interest rate.
   (b) decreases output, net exports, and the interest rate.
   (c) decreases output and net exports and increases the interest rate.
   (d) increases output, and decreases net exports and the interest rate.
   (e) decreases output and the interest rate, and increases net exports.
   Answer: B
   Question Status: New
180) An autonomous decrease in the value of the domestic exchange rate
   (a) increases output, net exports, and the interest rate.
   (b) decreases output, net exports, and the interest rate.
   (c) decreases output and net exports and increases the interest rate.
   (d) increases output, and decreases net exports and the interest rate.
   (e) decreases output and the interest rate, and increases net exports.
   Answer: A

Question Status: New

■ Essay Questions

1) Using the ISLM model, show graphically and explain the effects of a monetary expansion combined with a fiscal contraction. How do the equilibrium level of output and interest rate change?
   Answer: The monetary expansion shifts the LM curve to the right, from LM to LM', and the fiscal contraction shifts the IS curve to the left, from IS to IS'. The equilibrium interest rate unambiguously falls, while the effect on output is indeterminate. The graph below shows Y increasing, but that result depends on the way the graph is drawn. Students should know the outcome cannot be determined unambiguously.
2) Using the ISLM model, show graphically and explain the effects of a monetary contraction. What is the effect on the equilibrium interest rate and level of output?

Answer: The monetary contraction shifts the LM curve from LM to LM'. The result is that the equilibrium level of output falls from Y to Y', and the equilibrium interest rate increases from i to i'.
4) Show graphically and explain why targeting an interest rate is preferable when money demand is unstable and the IS curve is stable.

Answer: Unstable money demand causes the LM curve to shift between $LM'$ and $LM''$. If the money supply is targeted, output fluctuates between $Y'$ and $Y''$. With an interest rate target, output remains stable at $Y$. Since the objective is to minimize output fluctuations, targeting the interest rate is preferable.

5) Using the long-run ISLM model, explain and demonstrate graphically the neutrality of money, for the case of an increase in the money supply.

Answer: The increase in the money supply shifts LM to the right, increasing output to $Y'$, above the natural rate $Y^*$. The interest rate falls from $i$ to $i'$. Excess demand increases the price level, reducing the real value of the money supply. The LM curve shifts back until the all pressure on prices is eliminated by the return to the natural rate of output. The initial and final levels of output and interest rate are the same. No real variables have changed.