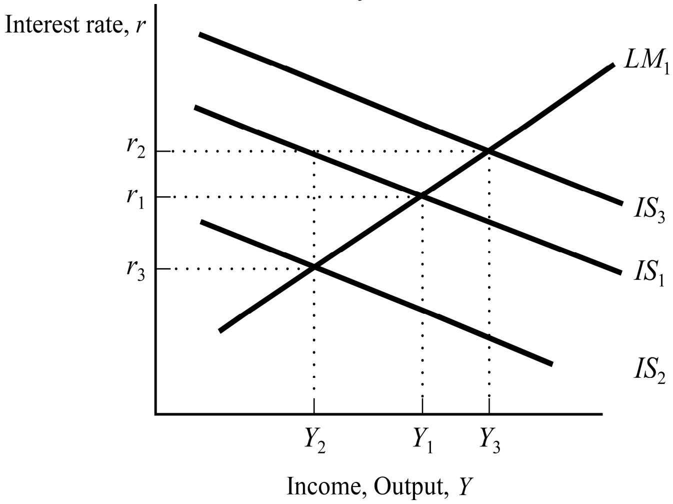
Name: ___________________________________ Date: ______________

1. The interaction of the *IS* curve and the *LM* curve together determine:
   A) the price level and the inflation rate.
   B) the interest rate and the price level.
   C) investment and the money supply.
   D) the equilibrium level of the interest rate and output.

Use the following to answer questions 2-3.

Exhibit: *IS*–*LM* Fiscal Policy



2. (Exhibit: *IS*–*LM* Fiscal Policy) Based on the graph, starting from equilibrium at interest rate r_1 and income Y_1, a decrease in government spending would generate the new equilibrium combination of interest rate and income:
   A) r_2, Y_2
   B) r_3, Y_2
   C) r_2, Y_3
   D) r_3, Y_3

3. (Exhibit: *IS–LM* Fiscal Policy) Based on the graph, starting from equilibrium at interest rate r_1 and income Y_1, an increase in government spending would generate the new equilibrium combination of interest rate and income:
   A) r_2, Y_2
   B) r_3, Y_2
   C) r_2, Y_3
   D) r_3, Y_3

4. In the *IS–LM* model, the impact of an increase in government purchases in the goods market has ramifications in the money market, because the increase in income causes a(n) ______ in money ______.
   A) increase; supply
   B) increase; demand
   C) decrease; supply
   D) decrease; demand

5. If *MPC* = 0.75 (and there are no income taxes) when *G* increases by 100, then the *IS* curve for any given interest rate shifts to the right by:
   A) 100.
   B) 200.
   C) 300.
   D) 400.

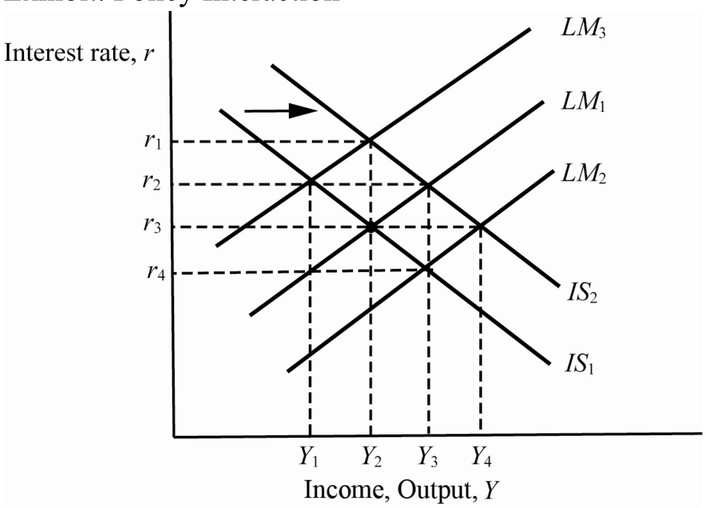
6. In the *IS–LM* analysis, the increase in income resulting from a tax cut is usually ______ the increase in income resulting from an equal rise in government spending.
   A) less than
   B) greater than
   C) equal to
   D) sometimes less and sometimes greater than

7. In the *IS–LM* model when the Federal Reserve decreases the money supply, people ______ bonds and the interest rate ______, leading to a(n) ______ in investment and income.
   A) buy; rises; increase
   B) sell; falls; decrease
   C) sell; rises; decrease
   D) buy; rises; decrease

8. According to the *IS–LM* model, if Congress raises taxes but the Fed wants to hold the interest rate constant, then the Fed must ______ the money supply.
   A) increase
   B) decrease
   C) first increase and then decrease
   D) first decrease and then increase

Use the following to answer questions 9-10.

Exhibit: Policy Interaction



9. (Exhibit: Policy Interaction) Based on the graph, starting from equilibrium at interest rate r_3, income Y_2, IS_1, and LM_1, if there is an increase in government spending that shifts the *IS* curve to IS_2, then in order to keep the interest rate constant, the Federal Reserve should _____ the money supply shifting to _____.
   A) increase; LM_2
   B) decrease; LM_2
   C) increase; LM_3
   D) decrease; LM_3

10. (Exhibit: Policy Interaction) Based on the graph, starting from equilibrium at interest rate r_3, income Y_2, IS_1, and LM_1, if there is an increase in government spending that shifts the *IS* curve to IS_2, then in order to keep output constant, the Federal Reserve should _____ the money supply shifting to _____.
A) increase; LM_2
B) decrease; LM_2
C) increase; LM_3
D) decrease; LM_3

11. An increase in the demand for money, at any given income level and level of interest rates, will, within the *IS–LM* framework, ______ output and ______ interest rates.
A) increase; lower
B) increase; raise
C) lower; lower.
D) lower; raise

12. The U.S. recession of 2001 can be explained in part by a declining stock market and terrorist attacks. Both of these shocks can be represented in the *IS–LM* model by shifting the ______ curve to the ______.
A) *LM*; right
B) *LM*; left
C) *IS*; right
D) *IS*; left

13. One policy response to the U.S. economic slowdown of 2001 was tax cuts. This policy response can be represented in the *IS–LM* model by shifting the ______ curve to the ______.
A) *LM*; right
B) *LM*; left
C) *IS*; right
D) *IS*; left

14. One policy response to the U.S. economic slowdown of 2001 was to increase money growth. This policy response can be represented in the *IS*–*LM* model by shifting the ______ curve to the ______.
   A) *LM*; right
   B) *LM*; left
   C) *IS*; right
   D) *IS*; left

15. When bond traders for the Federal Reserve seek to decrease interest rates, they ______ bonds, which shifts the ______ curve to the right.
   A) buy; *IS*
   B) buy; *LM*
   C) sell; *IS*
   D) sell; *LM*

16. When bond traders for the Federal Reserve seek to increase interest rates, they ______ bonds, which shifts the ______ curve to the left.
   A) buy; *IS*
   B) buy; *LM*
   C) sell; *IS*
   D) sell; *LM*

17. A tax cut shifts the ______ to the right, and the aggregate demand curve ______.
   A) *IS*; shifts to the right
   B) *IS*; does not shift
   C) *LM*: shifts to the right
   D) *LM*; does not shift

18. The money hypothesis suggests that the Great Depression was caused by a:
   A) leftward shift in the *IS* curve.
   B) rightward shift in the *IS* curve.
   C) leftward shift in the *LM* curve.
   D) rightward shift in the *LM* curve.

19. The Pigou effect:
    A) suggests that as prices fall and real money balances rise, consumers should feel less wealthy and spend less.
    B) suggests that as prices fall and real money balances rise, consumers should feel wealthier and spend more.
    C) suggests that as prices fall and real money balances rise, consumers should feel less wealthy but spend more.
    D) is generally accepted as adequate proof that the economy must be able to correct itself.

20. During the financial crisis of 2008–2009, many financial institutions stopped making loans even to creditworthy customers, which could be represented in the *IS*–*LM* model as a(n):
    A) expansionary shift in the *IS* curve.
    B) contractionary shift in the *IS* curve.
    C) expansionary shift in the *LM* curve.
    D) contractionary shift in the *LM* curve.

21. A liquidity trap occurs when:
    A) banks have too much currency and close their doors to new customers.
    B) the central bank mistakenly prints too much money, generating hyperinflation.
    C) interest rates fall so low that monetary policy is no longer effective.
    D) dams and locks are built to prevent flooding.

22. The slope of the *IS* curve depends on:
    A) the interest sensitivity of investment and the amount of government spending.
    B) the interest sensitivity of investment and the marginal propensity to consume.
    C) the interest sensitivity of investment and the tax rates.
    D) tax rates and government spending.

23. If the demand function for money is $M/P = 0.5Y - 100r$, then the slope of the *LM* curve is:
    A) 0.001.
    B) 0.005.
    C) 0.01.
    D) 0.05.

24. Other things equal, a given change in government spending has a larger effect on demand the:
   A) flatter the *LM* curve.
   B) steeper the *LM* curve.
   C) smaller the interest sensitivity of money demand.
   D) larger the income sensitivity of money demand.

25. If consumption is given by $C = 200 + 0.75(Y - T)$ and investment is given by $I = 200 - 25r$, then the formula for the *IS* curve is:
   A) $Y = 400 - 0.75T - 25r + G$.
   B) $Y = 1{,}600 - 3T - 100r + 4G$.
   C) $Y = 400 + 0.75T - 25r - G$.
   D) $Y = 1{,}600 + 3T - 100r - 4G$.

26. If the *IS* curve is given by $Y = 1{,}700 - 100r$ and the *LM* curve is given by $Y = 500 + 100r$, then equilibrium income and interest rate are given by:
   A) $Y = 1{,}100$, $r = 6$ percent.
   B) $Y = 1{,}200$, $r = 5$ percent.
   C) $Y = 1{,}000$, $r = 5$ percent.
   D) $Y = 1{,}100$, $r = 5$ percent.