Name: ___________________________________ Date: ______________

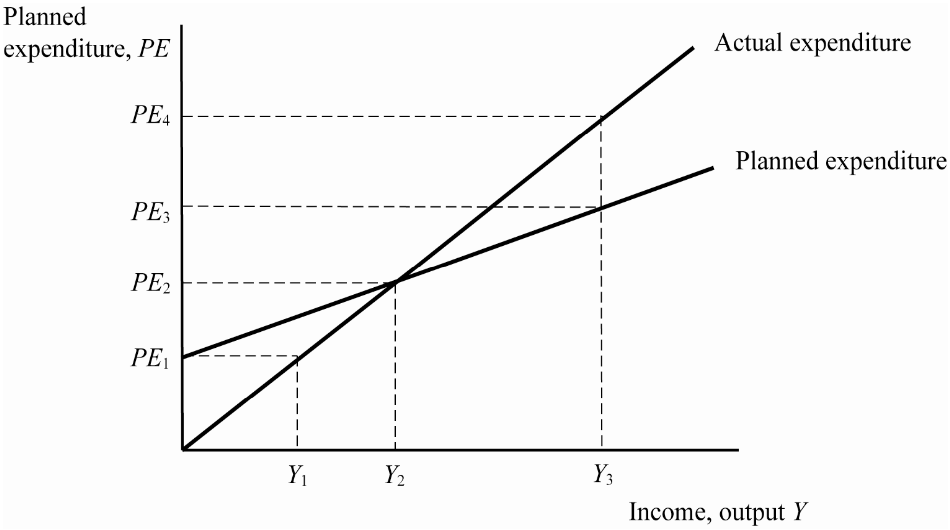
1. A variable that links the market for goods and services and the market for real money balances in the *IS*–*LM* model is the:
   A) consumption function.
   B) interest rate.
   C) price level.
   D) nominal money supply.

2. In the *IS*–*LM* model, which two variables are influenced by the interest rate?
   A) supply of nominal money balances and demand for real balances
   B) demand for real money balances and government purchases
   C) supply of nominal money balances and investment spending
   D) demand for real money balances and investment spending

3. The *IS* curve plots the relationship between the interest rate and ______ that arises in the market for ______.
   A) national income; goods and services
   B) the price level; goods and services
   C) national income; money
   D) the price level; money

Use the following to answer questions 4-5.

Exhibit: Keynesian Cross



4. (Exhibit: Keynesian Cross) In this graph, the equilibrium levels of income and expenditure are:
   A) Y_1 and PE_1.
   B) Y_2 and PE_2.
   C) Y_3 and PE_3.
   D) Y_3 and PE_4.

5. (Exhibit: Keynesian Cross) In this graph, if firms are producing at level Y_1, then inventories will ______, inducing firms to ______ production.
   A) rise; increase
   B) rise; decrease
   C) fall; increase
   D) fall; decrease

6. The government-purchases multiplier indicates how much ______ change(s) in response to a $1 change in government purchases.
   A) the budget deficit
   B) consumption
   C) income
   D) real balances

7. In the Keynesian-cross model, if government purchases increase by 100, then planned expenditures ______ for any given level of income.
   A) increase by 100
   B) increase by more than 100
   C) decrease by 100
   D) increase, but by less than 100

8. In the Keynesian-cross model, fiscal policy has a multiplied effect on income because fiscal policy:
   A) increases the amount of money in the economy.
   B) changes income, which changes consumption, which further changes income.
   C) is government spending and, therefore, more powerful than private spending.
   D) changes the interest rate.

9. According to the Keynesian-cross analysis, if *MPC* stands for marginal propensity to consume, then a rise in taxes of ΔT will:
   A) decrease equilibrium income by ΔT.
   B) decrease equilibrium income by $\Delta T/(1 - MPC)$.
   C) decrease equilibrium income by $(\Delta T)(MPC)/(1 - MPC)$.
   D) not affect equilibrium income at all.

10. After the Kennedy tax cut in 1964, real GDP:
    A) fell and unemployment rose.
    B) rose and unemployment fell.
    C) and unemployment both rose.
    D) and unemployment both fell.

11. An increase in the interest rate:
    A) reduces planned investment, because the interest rate is the cost of borrowing to finance investment projects.
    B) increases planned investment, because people who make money from interest have more money to invest.
    C) has no effect on investment.
    D) may be caused by a drop in investment demand.

12. An explanation for the slope of the *IS* curve is that as the interest rate increases, the quantity of investment ______, and this shifts the expenditure function ______, thereby decreasing income.
   A) increases; downward
   B) increases; upward
   C) decreases; upward
   D) decreases; downward

13. The *IS* curve shifts when any of the following economic variables change *except*:
   A) the interest rate.
   B) government spending.
   C) tax rates.
   D) the marginal propensity to consume.

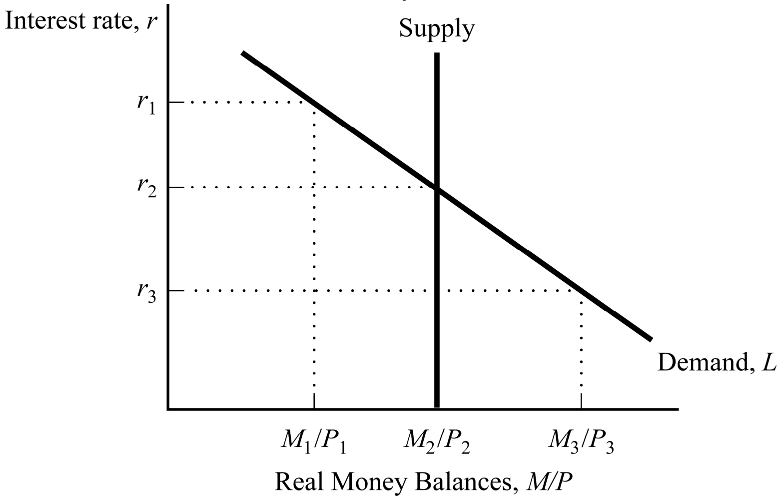
14. An increase in government spending generally shifts the *IS* curve, drawn with income along the horizontal axis and the interest rate along the vertical axis:
   A) downward and to the left.
   B) upward and to the right.
   C) upward and to the left.
   D) downward and to the right.

15. An *IS* curve shows combinations of:
   A) taxes and government spending.
   B) nominal money balances and price levels.
   C) interest rates and income that bring equilibrium in the market for real balances.
   D) interest rates and income that bring equilibrium in the market for goods and services.

16. According to the theory of liquidity preference, the supply of real money balances:
   A) decreases as the interest rate increases.
   B) increases as the interest rate increases.
   C) increases as income increases.
   D) is fixed.

Use the following to answer questions 17-18.

Exhibit: Market for Real Money Balances



17. (Exhibit: Market for Real Money Balances) Based on the graph, the equilibrium levels of interest rates and real money balances are:
    A) r_1 and M_1/P_1
    B) r_2 and M_2/P_2
    C) r_3 and M_2/P_2
    D) r_3 and M_3/P_3

18. (Exhibit: Market for Real Money Balances) Based on the graph, if the interest rate is r_3, then people will ______ bonds and the interest rate will ______.
    A) sell; rise
    B) sell; fall
    C) buy; rise
    D) buy; fall

19. According to the theory of liquidity preference, holding the supply of real money balances constant, an increase in income will ______ the demand for real money balances and will ______ the interest rate.
    A) increase; increase
    B) increase; decrease
    C) decrease; decrease
    D) decrease; increase

20. A decrease in the real money supply, other things being equal, will shift the *LM* curve:
   A) downward and to the left.
   B) upward and to the left.
   C) downward and to the right.
   D) upward and to the right.

21. Changes in monetary policy shift the:
   A) *LM* curve.
   B) planned spending curve.
   C) money demand curve.
   D) *IS* curve.

22. The *LM* curve shows combinations of ______ that are consistent with equilibrium in the market for real money balances.
   A) inflation and unemployment
   B) the price level and real output
   C) the interest rate and the level of income
   D) the interest rate and real money balances

23. The *IS* and *LM* curves together generally determine:
   A) income only.
   B) the interest rate only.
   C) both income and the interest rate.
   D) income, the interest rate, and the price level.

24. The intersection of the *IS* and *LM* curve determines the values of:
   A) r, Y, and P, given G, T, and M.
   B) r, Y, and M, given G, T, and P.
   C) r and Y, given G, T, M, and P.
   D) p and Y, given G, T, and M.

25. The *IS*–*LM* model is generally used:
   A) only in the short run.
   B) only in the long run.
   C) both in the short run and the long run.
   D) in determining the price level.

26. In the Keynesian-cross analysis, if the consumption function is given by $C = 100 + 0.6(Y - T)$, and planned investment is 100, G is 100, and T is 100, then equilibrium Y is:
A) 350.
B) 400.
C) 600.
D) 750.