Chapter 21
Monetary and Fiscal Policy in the ISLM Model

21.1 Factors That Cause the IS Curve to Shift

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
   Ques 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 _______, everything else held constant.
   A) up; rise
   B) up; fall
   C) down; rise
   D) down; fall

   Answer: D
   Ques Status: Revised

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 _______, everything else held constant.
   A) up; rise
   B) up; fall
   C) down; rise
   D) down; fall

   Answer: A
   Ques Status: Revised
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 ________, everything else held constant.

   A) up; left  
   B) up; right  
   C) down; left  
   D) down; right

Answer: B  
Ques Status: Revised

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 ________, everything else held constant.

   A) up; left  
   B) up; right  
   C) down; left  
   D) down; right

Answer: C  
Ques Status: Revised

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 ________, everything else held constant.

   A) rise; left  
   B) rise; right  
   C) fall; left  
   D) fall; right

Answer: C  
Ques Status: Revised

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 ________, everything else held constant.

   A) rise; left  
   B) rise; right  
   C) fall; left  
   D) fall; right

Answer: B  
Ques Status: Revised
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 ________, everything else held constant.
   A) rise; LM; right
   B) rise; IS; right
   C) fall; LM; left
   D) fall; IS; left
   Answer: B
   Ques Status: Revised

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 ________, everything else held constant.
   A) rise; LM; right
   B) rise; IS; right
   C) fall; IS; left
   D) fall; LM; left
   Answer: C
   Ques Status: Revised

10) Everything else held constant, changes in the interest rate affect planned investment spending and hence the equilibrium level of output, but this change in investment spending
   A) merely causes a movement along the IS curve and not a shift.
   B) is crowded out by higher taxes.
   C) is crowded out by higher government spending.
   D) is crowded out by lower consumer expenditures.
   Answer: A
   Ques Status: Revised

11) A rise in autonomous planned investment spending causes the equilibrium level of aggregate output to _______ and shifts the _______ curve to the ________, everything else held constant.
    A) rise; LM; right
    B) rise; IS; right
    C) fall; IS; left
    D) fall; LM; left
    Answer: B
    Ques Status: Revised
12) A decline in autonomous planned investment spending causes the equilibrium level of aggregate output to _______ and shifts the _______ curve to the _______, everything else held constant.
   A) rise; LM; right
   B) rise; IS; right
   C) fall; IS; left
   D) fall; LM; left

   Answer: C

   Ques Status: Revised

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 _______, everything else held constant.
   A) up; rise
   B) up; fall
   C) down; rise
   D) down; fall

   Answer: D

   Ques Status: Revised

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 _______, everything else held constant.
   A) up; rise
   B) up; fall
   C) down; rise
   D) down; fall

   Answer: A

   Ques Status: Revised
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 ________, everything else held constant.

   A) up; left
   B) up; right
   C) down; left
   D) down; right

   Answer: B  
   Ques Status: Revised

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 ________, everything else held constant.

   A) up; left
   B) up; right
   C) down; left
   D) down; right

   Answer: C  
   Ques Status: Revised

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 ________, everything else held constant.

   A) rise; left
   B) rise; right
   C) fall; left
   D) fall; right

   Answer: C  
   Ques Status: Revised
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 ________, everything else held constant.
   A) rise; left
   B) rise; right
   C) fall; left
   D) fall; right
   Answer: B
   Ques Status: Revised

19) A decrease in autonomous planned investment spending, other things equal, shifts the ________ curve to the ________.
   A) IS; right
   B) IS; left
   C) LM; left
   D) LM; right
   Answer: B
   Ques Status: Revised

20) An increase in government spending causes the equilibrium level of aggregate output to ________ at any given interest rate and shifts the ________ curve to the ________, everything else held constant.
   A) rise; LM; right
   B) rise; IS; right
   C) fall; IS; left
   D) fall; LM; left
   Answer: B
   Ques Status: Revised

21) A reduction in government spending causes the equilibrium level of aggregate output to ________ at any given interest rate and shifts the ________ curve to the ________, everything else held constant.
   A) rise; LM; right
   B) fall; IS; left
   C) fall; LM; left
   D) rise; IS; right
   Answer: B
   Ques Status: Revised
22) The IS curve shifts to the left when
   A) taxes increase.
   B) government spending increases.
   C) the money supply increases.
   D) autonomous planned investment spending increases.

   Answer: A
   Ques Status: Revised

23) A decline in taxes ______ consumer expenditure and shifts the ______ curve to the ______, everything else held constant.
   A) raises; LM; right
   B) lowers; IS; left
   C) raises; IS; right
   D) lowers; LM; left

   Answer: C
   Ques Status: Revised

24) A tax increase ______ disposable income, ______ consumption expenditure, and shifts the IS curve to the ______, everything else held constant.
   A) increases; increases; right
   B) increases; decreases; left
   C) decreases; increases; left
   D) decreases; decreases; left

   Answer: D
   Ques Status: Revised

25) A tax cut ______ disposable income, ______ consumption expenditure, and shifts the IS curve to the ______, everything else held constant.
   A) increases; increases; right
   B) increases; decreases; right
   C) decreases; increases; left
   D) decreases; decreases; left

   Answer: A
   Ques Status: Revised
26) If American college students decide that drinking Mexican-brewed beer helps one get noticed, net exports will tend to fall, causing aggregate demand to _______ and the _______ curve to shift to the left, everything else held constant.
   A) fall; LM
   B) fall; IS
   C) rise; LM
   D) rise; IS

   Answer: B
   Ques Status: Revised

27) 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 _______, everything else held constant.
   A) fall; fall
   B) fall; rise
   C) rise; fall
   D) rise; rise

   Answer: A
   Ques Status: Revised

28) An autonomous depreciation of the U.S. dollar makes American goods _______ relative to foreign goods and results in a _______ in U.S. net exports, everything else held constant.
   A) cheaper; decline
   B) cheaper; rise
   C) more expensive; decline
   D) more expensive; rise

   Answer: B
   Ques Status: Revised

29) An autonomous appreciation of the U.S. dollar makes American goods _______ expensive relative to foreign goods which _______ net exports in the U.S.
   A) less; decreases
   B) less; increases
   C) more; decreases
   D) more; increases

   Answer: C
   Ques Status: Revised
30) A shift in tastes toward foreign goods _______ net exports in the U.S. and causes the quantity of aggregate output demanded to _______ in the U.S., everything else held constant.

A) decreases; rise  
B) decreases; fall  
C) increases; rise  
D) increases; fall  

Answer: B  
Ques Status: Revised

31) Everything else held constant, a shift in tastes in the U.S. toward Mexican goods will _______ net exports in the U.S. and cause the quantity of aggregate output demanded to _______ in Mexico.

A) decrease; rise  
B) decrease; fall  
C) increase; rise  
D) increase; fall  

Answer: A  
Ques Status: New

32) A shift in tastes toward American goods _______ net exports in the U.S. and causes the quantity of aggregate output demanded to _______ in the U.S., everything else held constant.

A) decreases; rise  
B) decreases; fall  
C) increases; rise  
D) increases; fall  

Answer: C  
Ques Status: Revised

33) Everything else held constant, a shift in tastes in the U.S. towards American goods will _______ net exports in the U.S. and cause the quantity of aggregate output demanded to _______ in Mexico.

A) decrease; rise  
B) decrease; fall  
C) increase; rise  
D) increase; fall  

Answer: D  
Ques Status: New
34) A shift in tastes toward American goods _______ net exports in the U.S. and causes the IS curve to shift to the _______ in the U.S., everything else held constant.
   A) decreases; right
   B) decreases; left
   C) increases; right
   D) increases; left
   Answer: C
   Ques Status: Revised

35) A shift in tastes toward foreign goods _______ net exports in the U.S. and causes the IS curve to shift to the _______ in the U.S., everything else held constant.
   A) decreases; right
   B) decreases; left
   C) increases; right
   D) increases; left
   Answer: B
   Ques Status: Revised

36) A depreciation of the U.S. dollar makes American goods cheaper relative to foreign goods, resulting in a _______ in net exports in the U.S. and a _______ shift of the IS curve in the U.S., everything else held constant.
   A) fall; leftward
   B) rise; leftward
   C) fall; rightward
   D) rise; rightward
   Answer: D
   Ques Status: Revised

37) An appreciation of the U.S. dollar makes foreign goods cheaper relative to American goods, resulting in a _______ in net exports in the U.S. and a _______ shift of the IS curve in the U.S., everything else held constant.
   A) fall; leftward
   B) rise; leftward
   C) fall; rightward
   D) rise; rightward
   Answer: A
   Ques Status: Revised
38) 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

21.2 Factors That Cause the LM Curve to Shift

1) 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

2) If the Federal Reserve conducts open market purchases, the money supply _______, shifting the LM curve to the _______, everything else held constant.

A) decreases; right
B) decreases; left
C) increases; right
D) increases; left

Answer: C

3) If the Federal Reserve conducts open market sales, the money supply _______, shifting the LM curve to the _______, everything else held constant.

A) decreases; right
B) decreases; left
C) increases; right
D) increases; left

Answer: B
4) If the Federal Reserve conducts open market ______, the money supply ______, shifting the LM curve to the right, everything else held constant.
   A) purchases; decreases
   B) sales; decreases
   C) purchases; increases
   D) sales; increases
   Answer: C
   Ques Status: Revised

5) If the Federal Reserve conducts open market ______, the money supply ______, shifting the LM curve to the left, everything else held constant.
   A) purchases; decreases
   B) sales; decreases
   C) purchases; increases
   D) sales; increases
   Answer: B
   Ques Status: Revised

6) An increase in the quantity of money supplied shifts the money supply curve to the ______, and the equilibrium interest rate ______, everything else held constant.
   A) right; falls
   B) right; rises
   C) left; falls
   D) left; rises
   Answer: A
   Ques Status: Revised

7) A decrease in the quantity of money supplied shifts the money supply curve to the ______, and the equilibrium interest rate ______, everything else held constant.
   A) right; falls
   B) right; rises
   C) left; falls
   D) left; rises
   Answer: D
   Ques Status: Revised
8) An increase in the quantity of money supplied shifts the money supply curve to the _______ and the LM curve to the _______, everything else held constant.
   A) right; left
   B) right; right
   C) left; left
   D) left; right
   Answer: B
   Ques Status: Revised

9) A decrease in the quantity of money supplied shifts the money supply curve to the _______, and the LM curve to the _______, everything else held constant.
   A) right; left
   B) right; right
   C) left; left
   D) left; right
   Answer: C
   Ques Status: Revised

10) A decline in the money _______ shifts the LM curve to the _______, causing the interest rate to rise and output to fall, everything else held constant.
    A) demand; right
    B) demand; left
    C) supply; right
    D) supply; left
    Answer: D
    Ques Status: Revised

11) A decline in the money supply shifts the LM curve to the left, causing the interest rate to _______ and output to _______, everything else held constant.
    A) rise; rise
    B) rise; fall
    C) fall; rise
    D) fall; fall
    Answer: B
    Ques Status: Revised
12) An increase in the money _______ shifts the LM curve to the _______, causing the interest rate to fall and output to rise, everything else held constant.
   A) demand; right  
   B) demand; left  
   C) supply; right  
   D) supply; left  
   Answer: C  
   Ques Status: Revised

13) An increase in the money supply shifts the LM curve to the right, causing the interest rate to _______ and output to _______, everything else held constant.
   A) rise; rise  
   B) rise; fall  
   C) fall; rise  
   D) fall; fall  
   Answer: C  
   Ques Status: Revised

14) When the central bank _______ the money supply, the LM curve shifts to the right, interest rates _______, and equilibrium aggregate output _______, everything else held constant.
   A) increases; fall; increases  
   B) increases; rise; decreases  
   C) decreases; rise; decreases  
   D) decreases; fall; increases  
   Answer: A  
   Ques Status: Revised

15) An autonomous 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  
   Ques Status: Revised
16) An autonomous 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  
   Ques Status: Revised

17) 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  
   Ques Status: Revised

18) An autonomous rise in _______ shifts the LM curve to the _______, everything else held constant.
   A) net exports; right  
   B) net exports; left  
   C) money demand; right  
   D) money demand; left  
   Answer: D  
   Ques Status: Revised

21.3 Changes in Equilibrium Level of the Interest Rate and Aggregate Output

1) In the ISLM framework, an expansionary monetary policy causes aggregate output to _______ and the interest rate to _______, everything else held constant.
   A) increase; increase  
   B) increase; decrease  
   C) decrease; decrease  
   D) decrease; increase  
   Answer: B  
   Ques Status: Revised
2) An expansionary monetary policy shifts the LM curve to the ________, reducing _______, everything else held constant.
   A) left; output and increasing interest rates
   B) left; both real output and interest rates
   C) right; both interest rates and real output
   D) right; interest rates and increasing real output
   Answer: D  
   Ques Status: Revised

3) A monetary expansion is characterized by
   A) rising output and interest rates.
   B) rising output and falling interest rates.
   C) falling output and rising interest rates.
   D) falling output and interest rates.
   Answer: B  
   Ques Status: Revised

4) A contractionary monetary policy shifts the LM curve to the ________, reducing _______, everything else held constant.
   A) left; output and increasing interest rates
   B) left; both real output and interest rates
   C) right; both interest rates and real output
   D) right; interest rates and increasing real output
   Answer: A  
   Ques Status: Revised

5) A monetary contraction is characterized by
   A) rising output and interest rates.
   B) rising output and falling interest rates.
   C) falling output and rising interest rates.
   D) falling output and interest rates.
   Answer: C  
   Ques Status: Revised
6) 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, everything else held constant.

   A) rise; rise
   B) rise; fall
   C) fall; rise
   D) fall; fall

   Answer: C
   Ques Status: Revised

7) 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, everything else held constant.

   A) rise; rise
   B) rise; fall
   C) fall; rise
   D) fall; fall

   Answer: B
   Ques Status: Revised

8) In the ISLM framework, an expansionary fiscal policy causes aggregate output to _______ and the interest rate to _______, everything else held constant.

   A) increase; increase
   B) increase; decrease
   C) decrease; decrease
   D) decrease; increase

   Answer: A
   Ques Status: Revised

9) In the ISLM framework a contractionary fiscal policy causes aggregate output to _______ and the interest rate to _______, everything else held constant.

   A) increase; increase
   B) increase; decrease
   C) decrease; decrease
   D) decrease; increase

   Answer: C
   Ques Status: Revised
10) 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

11) 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

12) An increase in spending that results from expansionary _______ policy causes the interest rate to _______, everything else held constant.
   A) fiscal; rise
   B) fiscal; fall
   C) incomes; rise
   D) incomes; fall
   Answer: A

13) Despite an expansionary monetary policy, an economy experiences a recession. Everything else held constant, the recession could occur in spite of the rightward shift of the LM curve if
   A) consumer confidence decreases sharply.
   B) there is an investment boom.
   C) the money supply increases.
   D) taxes are cut.
   Answer: A
14) 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

Answer: D

Ques Status: Revised

15) Which of the following statements concerning Keynesian ISLM analysis is 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 causes a shift in the IS curve.  
C) A fall in the money supply shifts the LM curve to the right.  
D) Expansionary fiscal policy will cause the interest rate to fall.

Answer: A

Ques Status: Revised

16) Using the ISLM model, 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 which by itself would cause the interest rate to decrease and aggregate output to increase. The fiscal contraction shifts the IS curve to the left which by itself would cause the interest rate to decrease and aggregate output to decrease. Therefore, the equilibrium interest rate unambiguously falls, while the effect on output is indeterminate.

Ques Status: Revised
17) 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: See figure below.

The monetary contraction shifts the LM curve to the left. The result is that the equilibrium level of output falls and the equilibrium interest rate increases.

Ques Status: Revised

21.4 Effectiveness of Monetary Versus Fiscal Policy

1) 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

Ques Status: Previous Edition

2) 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 income.
   C) investment is unaffected by changes in the interest rate.
   D) investment is unaffected by changes in income.

Answer: A

Ques Status: Revised
3) 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
   Ques Status: Previous Edition

4) Crowding out will be more pronounced the closer to vertical is
   A) the IS curve.
   B) the LM curve.
   C) the consumption function.
   D) the aggregate demand function.
   Answer: B
   Ques Status: Revised

5) 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
   Ques Status: Previous Edition

6) The more 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 steeper is the LM curve.
   Answer: A
   Ques Status: Revised
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7) If the economy is characterized by a certain and stable LM curve, then ______ target produces ______ fluctuations in aggregate output.
   A) an interest rate; smaller  
   B) a money supply; smaller  
   C) a money supply; larger  
   D) an exchange rate; larger

   Answer: B
   Ques Status: Revised

8) If the economy is characterized by a stable IS curve and an unstable LM curve, then ______ target produces ______ fluctuations in aggregate output.
   A) an interest rate; larger  
   B) a money supply; smaller  
   C) a money supply; larger  
   D) an exchange rate; smaller

   Answer: C
   Ques Status: Revised

9) 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
   Ques Status: Previous Edition

10) 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
   Ques Status: Previous Edition
11) If the Fed adopts a policy of pegging the interest rate, a _______ in government spending forces the Fed to increase the money supply to prevent interest rates from _______.

A) fall; increasing
B) fall; decreasing
C) rise; decreasing
D) rise; increasing

Answer: D

Ques Status: Revised

12) Using the ISLM model, explain and show graphically the effect of a fiscal expansion when the demand for money is completely insensitive to changes in the interest rate. What is this effect called?

Answer: See figure below.

This is the total crowding out effect. The LM curve is vertical, so any shift of the IS curve affects only interest rates. The level of output is constant. The fiscal expansion shifts the IS curve rightward, increasing the interest rate.

Ques Status: Revised
13) Show graphically and explain why targeting an interest rate is preferable when money demand is unstable and the IS curve is stable.

Answer: See figure below.

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

Ques Status: Revised

21.5 ISLM Model in the Long Run

1) 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

Ques Status: Previous Edition

2) In the long-run ISLM model and with everything else held constant, 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

Ques Status: Revised
3) In the long-run ISLM model and with everything else held constant, 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
Ques Status: Revised

4) In the long-run ISLM model and with everything else held constant, 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
Ques Status: Revised

5) In the long-run ISLM model and with everything else held constant, the long-run effect of an expansionary monetary policy is to

A) increase real output and the interest rate.
B) not change either real output or the interest rate.
C) increase real output and leave the interest rate unchanged.
D) increase the interest rate and leave real output unchanged.

Answer: B
Ques Status: Revised

6) 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) has no effect on either real output or the real interest rate.

Answer: D
Ques Status: Revised
7) In the long-run ISLM model and with everything else held constant, the long-run effect of an expansionary fiscal policy is to
   A) increase real output and the interest rate.
   B) not change either real output or the interest rate.
   C) increase real output and leave the interest rate unchanged.
   D) increase the interest rate and leave real output unchanged.

Answer: D
Ques Status: Revised

8) In the long-run ISLM model and with everything else held constant, the long-run effect of a contractionary fiscal policy is to
   A) not change either real output or the interest rate.
   B) decrease real output and the interest rate.
   C) decrease real output and leave the interest rate unchanged.
   D) decrease the interest rate and leave real output unchanged.

Answer: D
Ques Status: Revised

9) In the long-run ISLM model and with everything else held constant, 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.

Answer: D
Ques Status: Revised

10) In the long-run ISLM model and with everything else held constant, 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.

Answer: C
Ques Status: Revised
11) In the long-run ISLM model and with everything else held constant, 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.
   Answer: C
   Ques Status: Revised

12) In the long-run ISLM model and with everything else held constant, 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.
   Answer: D
   Ques Status: Revised

13) In the long-run ISLM model and with everything else held constant, 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.
   Answer: D
   Ques Status: Revised

14) 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) neither monetary nor fiscal policy can change real output.
   Answer: D
   Ques Status: Revised
15) 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
   Ques Status: Previous Edition

16) 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: See figure below.

   ![Graph showing ISLM model]

   The increase in the money supply shifts LM to the right, increasing output to \( Y_2 \), above the natural rate \( Y_n \). The interest rate falls from \( i_1 \) to \( i_2 \). 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.

   Ques Status: Revised

21.6 ISLM Model and the Aggregate Demand Curve

1) 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
   Ques Status: Previous Edition
2) If the price level decreases, other things equal, the _______ curve shifts to the _______.
   A) IS; right
   B) IS; left
   C) LM; left
   D) LM; right
   Answer: D
   *Ques Status: Previous Edition*

3) 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
   *Ques Status: Previous Edition*

4) In deriving the aggregate demand curve a _______ in the price level leads to _______ in the
   real money supply because the nominal quantity of dollars can purchase _______ goods and
   services.
   A) decline; an increase; more
   B) decline; a decrease; more
   C) rise; an increase; fewer
   D) rise; a decrease; more
   Answer: A
   *Ques Status: Revised*

5) 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
   *Ques Status: Previous Edition*
6) 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.

Answer: A
Ques Status: Revised

7) 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
Ques Status: Previous Edition

8) 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
Ques Status: Previous Edition

9) Other things being equal, an increase in government spending will cause
   A) aggregate demand to increase.
   B) aggregate demand to decrease.
   C) the quantity of aggregate demand to increase.
   D) the quantity of aggregate demand to decrease.

Answer: A
Ques Status: Revised
10) Expansionary monetary policies, all else remaining the same, will cause
   A) the quantity of aggregate demand to increase.
   B) the quantity of aggregate demand to decrease.
   C) aggregate demand to decrease.
   D) aggregate demand to increase.

   Answer: D
   *Ques Status: Revised*

11) Contractionary monetary policies, other things being equal, will cause
   A) the quantity of aggregate demand to increase.
   B) the quantity of aggregate demand to decrease.
   C) aggregate demand to increase.
   D) aggregate demand to decrease.

   Answer: D
   *Ques Status: Revised*

12) Everything else held constant, a purchase of government securities by the Fed will cause
   A) aggregate demand to increase.
   B) aggregate demand to decrease.
   C) the quantity of aggregate demand to increase.
   D) the quantity of aggregate demand to decrease.

   Answer: A
   *Ques Status: Revised*

13) Everything else held constant, an increase in autonomous consumer spending will cause the IS curve to shift to the ______ and aggregate demand will ______.

   A) right; increase
   B) right; decrease
   C) left; increase
   D) left; decrease

   Answer: A
   *Ques Status: New*
14) Everything else held constant, a decrease in autonomous consumer spending will cause the IS curve to shift to the _______ and aggregate demand will _______.
   A) right; increase
   B) right; decrease
   C) left; increase
   D) left; decrease
   Answer: D
   Ques Status: New

15) Everything else held constant, an increase in autonomous planned investment spending will cause the IS curve to shift to the _______ and aggregate demand will _______.
   A) right; increase
   B) right; decrease
   C) left; increase
   D) left; decrease
   Answer: A
   Ques Status: New

16) Everything else held constant, a decrease in autonomous planned investment spending will cause the IS curve to shift to the _______ and aggregate demand will _______.
   A) right; increase
   B) right; decrease
   C) left; increase
   D) left; decrease
   Answer: D
   Ques Status: New

17) Everything else held constant, a decrease in net taxes will cause the IS curve to shift to the _______ and aggregate demand will _______.
   A) right; increase
   B) right; decrease
   C) left; increase
   D) left; decrease
   Answer: A
   Ques Status: New
18) Everything else held constant, an increase in net taxes will cause the IS curve to shift to the _______ and aggregate demand will _______.
   A) right; increase
   B) right; decrease
   C) left; increase
   D) left; decrease
   Answer: D
   Ques Status: New

19) Everything else held constant, an appreciation of the domestic currency will cause the IS curve to shift to the _______ and aggregate demand will _______.
   A) right; increase
   B) right; decrease
   C) left; increase
   D) left; decrease
   Answer: D
   Ques Status: New

20) Everything else held constant, a depreciation of the domestic currency will cause the IS curve to shift to the _______ and aggregate demand will _______.
   A) right; increase
   B) right; decrease
   C) left; increase
   D) left; decrease
   Answer: A
   Ques Status: New

21) Everything else held constant, a decrease in government spending will cause the IS curve to shift to the _______ and aggregate demand will _______.
   A) right; increase
   B) right; decrease
   C) left; increase
   D) left; decrease
   Answer: D
   Ques Status: New
21.7 Web Appendix: Algebra of the ISLM Model

1) An increase in the interest sensitivity of money demand will ________ the fiscal policy multiplier and will ________ the monetary policy multiplier.
   A) increase; increase
   B) increase; decrease
   C) decrease; increase
   D) decrease; decrease

   Answer: B
   Ques Status: New

2) An increase in the interest sensitivity of planned investment spending will ________ the fiscal policy multiplier and will ________ the monetary policy multiplier.
   A) increase; increase
   B) increase; decrease
   C) decrease; increase
   D) decrease; decrease

   Answer: C
   Ques Status: New

3) An autonomous appreciation 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.

   Answer: B
   Ques Status: Revised

4) An autonomous depreciation 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.

   Answer: A
   Ques Status: Revised