Chapter 12 Aggregate Demand in the Goods and Money Markets

12.1 Planned Investment and the Interest Rate

1 Multiple Choice

1) The market in which the equilibrium level of aggregate output is determined is the
A) labor market.
B) bond market.
C) money market.
D) goods market.
Answer: D

and the Interest Rate

2) The market in which the equilibrium level of the interest rate is determined is the
A) money market.
B) goods market.
C) labor market.
D) services market.
Answer: A

and the Interest Rate

3) The two links between the goods market and the money market are

A) income and the inflation rate.
B) the interest rate and the unemployment rate.
C) income and the interest rate.

D) the inflation rate and the unemployment rate.
Answer: C

and the Interest Rate

4) Which of the following is determined in the goods market?
A) the equilibrium interest rate
B) money demand
C) income
D) money supply
Answer: C

and the Interest Rate

5) Which of the following is determined in the money market?
A) the equilibrium interest rate
B) income
C) employment
D) the government budget
Answer: A

and the Interest Rate

6) If planned investment is perfectly unresponsive to changes in the interest rate, the planned investment schedule
A) has a negative slope.
B) is horizontal.
C) is vertical.
D) has a positive slope.
Answer: C

and the Interest Rate

7) If planned investment is perfectly responsive to changes in the interest rate, the planned investment schedule
A) has a negative slope.
B) is horizontal.
C) is vertical.
D) has a positive slope.
Answer: B

and the Interest Rate

8) The money market and the goods market are linked through the impact of the interest rate on
A) government spending.
B) planned investment.
C) money supply
D) unplanned spending.
Answer: B

and the Interest Rate

9) Which of the following equations represents equilibrium in the goods market?
A) $Y = M$s.
B) Md = $C + I + G$.
C) Md = Ms.
D) $Y = C + I + G$.
Answer: D

and the Interest Rate

Refer to the information provided in Figure 12.1 below to answer the questions that follow.
Figure 12.1
10) Refer to Figure 12.1. If the interest rate drops from 8% to 4%, planned investment
A) increases, causing aggregate expenditure and aggregate output to fall.
B) increases, causing aggregate expenditure to fall.
C) decreases, causing both aggregate expenditure and aggregate output to rise.
D) increases, causing both aggregate expenditure and aggregate output to rise.
Answer: D

and the Interest Rate

11) Refer to Figure 12.1. If the interest rate rises from 4% to 8%, planned investment
A) decreases, causing both aggregate expenditure and aggregate output to fall.
B) increases, causing aggregate expenditure to fall.
C) decreases, causing both aggregate expenditure and aggregate output to rise.
D) increases, causing both aggregate expenditure and aggregate output to rise.
Answer: A

and the Interest Rate

12) Refer to Figure 12.1. If the interest rate increases from 4% to 8%,
A) aggregate expenditure increases.
B) equilibrium aggregate output decreases.
C) planned expenditure increases.
D) both aggregate expenditure and aggregate output increase.
Answer: B

and the Interest Rate

13) Refer to Figure 12.1. If the interest rate decreases from 8% to 4%,
A) aggregate expenditure increases.
B) equilibrium aggregate output decreases.
C) planned expenditure decreases.
D) the money supply will increase.
Answer: A

and the Interest Rate

Refer to the information provided in Table 12.1 below to answer the questions that follow.
Table 12.1
A Hypothetical Investment Schedule
Interest Rate (%) Planned Investment ($ Billion)
369
12
15
18
400
360
320
280
240
200
14) Refer to Table 12.1. If the interest rate dropped from 15% to 6%, planned investment would ________ by $________ billion.
A) increase; 120 B) increase; 180 C) decrease; 120 D) decrease; 180
Answer: A

and the Interest Rate

15) Refer to Table 12.1. Suppose the expenditure multiplier is 3. An increase in the interest rate from 6% to 9%, ceteris paribus, would
A) increase planned expenditure by $120 billion.
B) increase aggregate expenditure by $120 billion.
C) decrease equilibrium output by $120 billion.
D) decrease planned investment by $120 billion.
Answer: C

and the Interest Rate

16) Refer to Table 12.1. Suppose the expenditure multiplier is 4. A drop in the interest rate from 15% to 9%, ceteris paribus, would increase equilibrium output by $________ billion.
A) 320
B) 20
C) 240
D) 160
Answer: A

and the Interest Rate

17) Refer to Table 12.1. Suppose the expenditure multiplier is 5 and the initial interest rate is 12%.A move to what interest rate will increase equilibrium output by 400 billion?
A) 3%
B) 6%
C) 9%
D) 18%
Answer: D

and the Interest Rate

18) Refer to Table 12.1. Suppose the expenditure multiplier is 5, the initial interest rate is 9%, and the initial equilibrium output is $600 billion. What is the interest rate that increases equilibrium output to $800 billion?
A) 12%
B) 15%
C) 6%
D) 3%
Answer: C

and the Interest Rate

19) Refer to Table 12.1. Suppose the expenditure multiplier is 10, and the initial interest rate is 15%. What would be the impact on the equilibrium output if the interest rate fell to 6%?
A) It would increase by $1,200 billion.
B) It would decrease by $1,200 billion.
C) It would decrease by $3,600 billion.
D) It would increase by $3,600 billion.
Answer: A

and the Interest Rate

20) Related to the *Economics in Practice* on p.221 [533]: According to a recent study by Simon Gilchrist, Fabio Natalucci, and Egon Zakrajsek, a one percentage point increase in the interest rate appropriate for a firm′s borrowing will lead to a
A) drop in investment spending of more than one percentage point.
B) rise in investment spending of more than one percentage point.
C) drop in investment spending of less than one percentage point.
D) rise in investment spending of less than one percentage point.
Answer: A

and the Interest Rate

21) Related to the *Economics in Practice* on p.221 [533]: According to a recent study by Simon Gilchrist, Fabio Natalucci, and Egon Zakrajsek, investment expenditures are ________ changes in interest rates.
A) highly sensitive to
B) highly insensitive to
C) completely independent of
D) positively related to
Answer: A

and the Interest Rate

2 True/False

1) The interest rate affects the goods market through its impact on money demand.
2) Answer: FALSE

and the Interest Rate

2) Income is determined in the money market.
Answer: FALSE

and the Interest Rate

3) The money market is linked to the goods market through the impact of interest rates on planned investment.
Answer: TRUE

and the Interest Rate

12.2 Equilibrium in Both the Goods and Money Markets
1 Multiple Choice
1) The interest rate is determined in the
A) money market and has no influence on the goods market.
B) money market and influences the level of planned investment and thus the goods market.
C) goods market and has no influence on the money market.
D) goods market and influences the level of planned investment and thus the money market.
Answer: B

Topic: Equilibrium in Both the Goods and Money Markets

2) Output is determined in
A) the goods market and also influences money demand and the interest rate.
B) the money market and also influences money demand and the interest rate.
C) the goods market with no influence from the money market.
D) the money market with no influence on the goods market.
Answer: A

Topic: Equilibrium in Both the Goods and Money Markets

3) When income increases, the money demand curve shifts to the ________, which ________ the interest rate with a fixed money supply.
A) right; increases
B) right; decreases
C) left; increases
D) left; decreases
Answer: A

Topic: Equilibrium in Both the Goods and Money Markets

4) When income ________, the money ________ curve shifts to the right.
A) increases; demand
B) increases; supply
C) decreases; demand
D) decreases; supply
Answer: A

Topic: Equilibrium in Both the Goods and Money Markets

2 True/False
1) When aggregate output falls, money demand and the interest rate fall.
Answer: TRUE

Topic: Equilibrium in Both the Goods and Money Markets

2) The money market is linked to the goods and services market by the impact of income on the demand for money.
Answer: TRUE

Topic: Equilibrium in Both the Goods and Money Markets

12.3 Policy Effects in the Goods and Money Markets
1 Multiple Choice
1) Fiscal policy affects the goods market through
A) changes in money supply.
B) changes in taxes and money supply.
C) changes in government spending and money supply.
D) changes in taxes and government spending.
Answer: D

Topic: Policy Effects in the Goods and Money Markets

346
2) Fiscal policy affects the money market through its effect on
A) income and money supply. B) income and money demand.
C) money supply and money demand. D) money supply and income.
Answer: B

Topic: Policy Effects in the Goods and Money Markets

3) Monetary policy affects the goods market through its effect on
A) the interest rate and planned investment.
B) the interest rate and money demand.
C) income and planned investment.
D) income and money demand.
Answer: A

Topic: Policy Effects in the Goods and Money Markets

4) Which of the following is an example of an expansionary fiscal policy?
A) the Fed selling government securities in the open market
B) the federal government increasing the marginal tax rate on incomes above $200,000
C) the federal government increasing the amount of money spent on public health programs
D) the federal government reducing pollution standards to allow firms to produce more output
Answer: C

Topic: Policy Effects in the Goods and Money Markets

5) The objective of a contractionary fiscal policy is to
A) reduce unemployment.
B) increase growth in output.
C) reduce inflation.
D) increase stagflation.
Answer: C

Topic: Policy Effects in the Goods and Money Markets

6) The objective of an expansionary fiscal policy is to
A) reduce unemployment.
B) reduce inflation.
C) reduce growth in output.
D) reduce growth in international trade.
Answer: A

Topic: Policy Effects in the Goods and Money Markets

7) A decrease in the money supply aimed at decreasing aggregate output is referred to as
A) contractionary fiscal policy.
B) expansionary fiscal policy.
C) expansionary monetary policy.
D) contractionary monetary policy.
Answer: D

Topic: Policy Effects in the Goods and Money Markets

8) An example of a contractionary monetary policy is
A) an increase in the required reserve ratio.
B) a decrease in the discount rate.
C) a reduction in the taxes banks pay on their profits.
D) the Fed buying government securities in the open market.
Answer: A

Topic: Policy Effects in the Goods and Money Markets

9) An example of an expansionary monetary policy is
A) a decrease in the required reserve ratio.
B) the Fed selling bonds in the open market.
C) an increase in the required reserve ratio.
D) a law placing a ceiling on the maximum interest rate that banks can pay to depositors.
Answer: A

Topic: Policy Effects in the Goods and Money Markets

10) An intended goal of contractionary fiscal and monetary policy is
A) an increase in interest rates.
B) an increase in the price level.
C) a decrease in the unemployment rate.
D) a decrease in the level of aggregate output.
Answer: D

Topic: Policy Effects in the Goods and Money Markets

Refer to the information provided in Figure 12.4 below to answer the questions that follow.
Figure 12.4
11) Refer to Figure 12.4. Planned investment could decrease from $12 million to $8 million if
A) the government increases government purchases.
B) the Fed increases the money supply.
C) the government reduces government purchases.
D) the government increases net taxes.
Answer: A

Topic: Policy Effects in the Goods and Money Markets

12) Refer to Figure 12.4. Planned investment could decrease from $16 million to $12 million if
A) the government reduces government purchases.
B) the Fed buys bonds in the open market.
C) the government reduces net taxes.
D) firms expect their sales to decrease in the future.
Answer: C

Topic: Policy Effects in the Goods and Money Markets

13) Refer to Figure 12.4. Planned investment could increase from $8 million to $12 million if
A) the government increases government purchases.
B) the government decreases net taxes.
C) the Fed sells bonds in the open market.
D) the Fed reduces the required reserve ratio.
Answer: D

Topic: Policy Effects in the Goods and Money Markets

14) Refer to Figure 12.4. Planned investment could decrease from $12 million to $8 million if
A) the government increases net taxes.
B) the government increases government purchases.
C) the Fed buys bonds in the open market.
D) Both B and C
Answer: B

Topic: Policy Effects in the Goods and Money Markets

15) Refer to Figure 12.4. Planned investment could decrease from $16 million to $12 million if
A) the government reduces government purchases.
B) the Fed sells bonds in the open market.
C) the Fed lowers the discount rate.
D) B and C
Answer: B

Topic: Policy Effects in the Goods and Money Markets

16) Refer to Figure 12.4. Planned investment could increase from $8 million to $12 million if
A) the government increases government purchases.
B) the government increases net taxes.
C) the Fed sells bonds in the open market.
D) the Fed lowers the discount rate.
Answer: D

Topic: Policy Effects in the Goods and Money Markets

17) Which of the following sequence of events follows an expansionary monetary policy?
A) $r\uparrow \Rightarrow I\downarrow \Rightarrow AE\downarrow \Rightarrow Y\downarrow$.
B) $r\uparrow \Rightarrow I\uparrow \Rightarrow AE\downarrow \Rightarrow Y\uparrow$.
C) $r\downarrow \Rightarrow I\uparrow \Rightarrow AE\uparrow \Rightarrow Y\uparrow$.
D) $r\downarrow \Rightarrow I\downarrow \Rightarrow AE\downarrow \Rightarrow Y\downarrow$.
Answer: C

Topic: Policy Effects in the Goods and Money Markets

18) Which of the following sequence of events follows a rise in the discount rate?
A) $r\downarrow \Rightarrow I\downarrow \Rightarrow AE\downarrow \Rightarrow Y\uparrow$.
B) $r\uparrow \Rightarrow I\downarrow \Rightarrow AE\downarrow \Rightarrow Y\downarrow$.
C) $r\downarrow \Rightarrow I\uparrow \Rightarrow AE\uparrow \Rightarrow Y\uparrow$.
D) $r\uparrow \Rightarrow I\uparrow \Rightarrow AE\uparrow \Rightarrow Y\uparrow$.
Answer: B

Topic: Policy Effects in the Goods and Money Markets

19) Which of the following sequence of events follows an expansionary fiscal policy?
A) $AE\uparrow \Rightarrow Y\uparrow \Rightarrow M\mathrm{d}\downarrow \Rightarrow r\downarrow \Rightarrow I\downarrow \Rightarrow AE\downarrow$.
B) $AE\uparrow \Rightarrow Y\uparrow \Rightarrow M\mathrm{d}\uparrow \Rightarrow r\uparrow \Rightarrow I\downarrow \Rightarrow AE\downarrow$.
C) $AE\downarrow \Rightarrow Y\downarrow \Rightarrow M\mathrm{d}\downarrow \Rightarrow r\downarrow \Rightarrow I\uparrow \Rightarrow AE\uparrow$.
D) $AE\downarrow \Rightarrow Y\uparrow \Rightarrow M\mathrm{d}\downarrow \Rightarrow r\downarrow \Rightarrow I\downarrow \Rightarrow AE\downarrow$.
Answer: B

Topic: Policy Effects in the Goods and Money Markets

20) Which of the following sequence of events follows an increase in net taxes?
A) $AE\uparrow \Rightarrow Y\uparrow \Rightarrow M\mathrm{d}\uparrow \Rightarrow r\uparrow \Rightarrow I\uparrow \Rightarrow AE\uparrow$.
B) $AE\downarrow \Rightarrow Y\uparrow \Rightarrow M\mathrm{d}\downarrow \Rightarrow r\uparrow \Rightarrow I\downarrow \Rightarrow AE\downarrow$.
C) $AE\uparrow \Rightarrow Y\uparrow \Rightarrow M\mathrm{d}\downarrow \Rightarrow r\downarrow \Rightarrow I\downarrow \Rightarrow AE\downarrow$.
D) $AE\downarrow \Rightarrow Y\downarrow \Rightarrow M\mathrm{d}\downarrow \Rightarrow r\downarrow \Rightarrow I\uparrow \Rightarrow AE\uparrow$.
Answer: D

Topic: Policy Effects in the Goods and Money Markets

21) If planned investment decreases as the interest rate increases, the size of the government spending multiplier will be
A) zero.
B) larger than the government spending multiplier that would result if planned investment were independent of the interest rate.
C) the same as the government spending multiplier that would result if planned investment were independent of the interest rate.
D) smaller than the government spending multiplier that would result if planned investment were independent of the interest rate.
Answer: D

Topic: Policy Effects in the Goods and Money Markets

22) If planned investment decreases as the interest rate increases, the absolute value of the tax multiplier will be
A) the same as the absolute value of the tax multiplier that would result if planned investment were independent of the interest rate.
B) larger than the absolute value of the tax multiplier that would result if planned investment were independent of the interest rate.
C) smaller than the absolute value of the tax multiplier that would result if planned investment were independent of the interest rate.
D) zero.
Answer: C

Topic: Policy Effects in the Goods and Money Markets

Refer to the information provided in Table 12.2 below and the following three assumptions to answer the questions that follow.

Table 12.2
A Hypothetical Economy
Consumption (*C*) $600 billion
Planned Investment (*I*) $300 billion
Government Spending $150 billion
Assume the following for the long run:
1. For every 1% increase (decrease) in interest rate, planned investment decreases (increases) by $5 billion.

2. For every $10 billion increase (decrease) in government spending, interest rate increases (decreases) by 1%.
3. The *MPC* = 0.8

23) Refer to Table 12.2. Assuming the economy is in equilibrium, how much is equilibrium output?
A) $750 billion.
B) $900 billion
C) $1,050 billion
D) $1,350 billion
Answer: C

Topic: Policy Effects in the Goods and Money Markets

24) Refer to Table 12.2. When government spending increases by $30 billion, the crowding-out effect can be represented by a
A) $30 billion decrease in investment.
B) $15 billion decrease in investment.
C) 3% decrease in the interest rate.
D) 1% increase in the interest rate.
Answer: B

Topic: Policy Effects in the Goods and Money Markets

25) Refer to Table 12.2. Taking the crowding-out effect into consideration, if government spending increases by $30 billion, equilibrium output
A) increases by $150 billion.
B) increases by $225 billion.
C) decreases by $150 billion.
D) increases by $75 billion.
Answer: D

Topic: Policy Effects in the Goods and Money Markets

26) Refer to Table 12.2. Taking the crowding-out effect into consideration, if government spending increases by $50 billion, the new equilibrium output is
A) $1,100 billion.
B) $1,175 billion.
C) $1,300 billion.
D) $1,000 billion.
Answer: B

Topic: Policy Effects in the Goods and Money Markets
27) The severity of the crowding-out effect will be reduced if
A) the Fed increases the money supply at the same time the federal government increases government spending.
B) the Fed decreases the money supply at the same time the federal government increases government spending.
C) the Fed does not change the money supply when the government increases government spending.
D) business firms become pessimistic about the future.
Answer: A

Topic: Policy Effects in the Goods and Money Markets

28) If the Fed decreases the money supply at the same time the federal government decreases government spending, the crowding-out effect
A) will not be affected.
B) will be increased.
C) will be reduced.
D) could either increase or decrease depending on the sensitivity of planned investment to the interest rate.
Answer: C

Topic: Policy Effects in the Goods and Money Markets

29) The steeper the planned investment schedule (curve)
A) the larger is the crowding-out effect.
B) the smaller is the crowding-out effect.
C) the larger is the change in planned investment as a result of changes in the interest rate.
D) the smaller is the change in money demand as a result of changes in the interest rate.
Answer: B

Topic: Policy Effects in the Goods and Money Markets

30) The flatter the planned investment schedule (curve)
A) the smaller is the change in planned investment as a result of changes in the interest rate.
B) the smaller is the crowding-out effect.
C) the larger is the crowding-out effect.
D) the larger is the change in money demand as a result of changes in the interest rate.
Answer: C

Topic: Policy Effects in the Goods and Money Markets

31) If planned investment does not fall when the interest rate rises, there will be
A) a slight crowding-out effect.
B) a substantial crowding-out effect.
C) no crowding-out effect.
D) a complete crowding-out effect.
Answer: C

Topic: Policy Effects in the Goods and Money Markets

32) Which of the following reduces the severity of the crowding-out effect whenever government spending increases?
A) An expansionary monetary policy
B) An expansionary fiscal policy
C) A contractionary monetary policy
D) A contractionary fiscal policy
Answer: A

Topic: Policy Effects in the Goods and Money Markets

33) There will be no crowding-out effect when the government increases spending and the planned investment schedule (curve) is
A) vertical.
B) downward sloping.
C) upward sloping.
D) horizontal.
Answer: A

Topic: Policy Effects in the Goods and Money Markets

34) If firms sharply increase the number of investment projects undertaken when interest rates fall and sharply reduce the number of investment projects undertaken when interest rates increase, then, ignoring the crowding out effect,
A) expansionary fiscal policy will be very effective.
B) expansionary monetary policy will be very effective.
C) contractionary fiscal policy will be very effective.
D) contractionary monetary policy will not be very effective.
Answer: B

Topic: Policy Effects in the Goods and Money Markets

35) If planned investment is sensitive to the interest rate, an increase in the interest rate causes the
A) aggregate expenditure curve to shift down.
B) aggregate expenditure curve to shift up.
C) long-run aggregate supply curve to shift out.
D) investment demand schedule to shift to the right.
Answer: A

Topic: Policy Effects in the Goods and Money Markets

36) Monetary policy can be effective only if
A) the money supply reacts to changes in the interest rate.
B) planned investment reacts to changes in the interest rate.
C) money demand reacts to changes in the interest rate.
D) government spending reacts to changes in the interest rate.
Answer: B

Topic: Policy Effects in the Goods and Money Markets

37) Dan, a writer for a business magazine, interviewed managers at 100 large corporations. All of the managers indicated that the primary determinant of planned investment is expected sales and not the interest rate. From this information, Dan concluded that
A) fiscal policy would be very effective, but monetary policy would not be very effective.
B) neither expansionary nor contractionary fiscal policy would be very effective.
C) both expansionary and contractionary monetary policy would be very effective.
D) contractionary fiscal policy would not be very effective, but contractionary monetary policy would bevery effective.
Answer: A

Topic: Policy Effects in the Goods and Money Markets

38) Assume that investment spending depends on the interest rate. As the supply of money is increased, the interest rate ________ and planned investment spending ________.
A) falls; increases
B) falls; decreases
C) rises; decreases
D) rises; increases
Answer: A

Topic: Policy Effects in the Goods and Money Markets

39) If the interest rate is so high that it is hurting economic growth, the recommended policy action should be
A) an expansionary fiscal policy.
B) an expansionary monetary policy.
C) a contractionary monetary policy.
D) the demand for money should be increased.
Answer: B

Topic: Policy Effects in the Goods and Money Markets

40) Monetary policy affects the money market by
A) changing the interest rate, which changes planned investment.
B) directly increasing consumption, which increases aggregate output.
C) changing the money supply, which changes the interest rate.
D) changing the level of aggregate output, which changes the level of planned expenditure.
Answer: C

Topic: Policy Effects in the Goods and Money Markets

41) If the investment demand curve is vertical,
A) both monetary and fiscal policy are ineffective.
B) both monetary and fiscal policy are effective.
C) monetary policy is effective, but fiscal policy is ineffective.
D) monetary policy is ineffective, but fiscal policy is effective.
Answer: D

Topic: Policy Effects in the Goods and Money Markets

42) If the federal government is reducing net taxes to stimulate the economy at the same time the Fed is selling bonds in the open market, the effectiveness of the expansionary fiscal policy will be
A) increased, because the Fed′s actions will result in higher interest rates.
B) reduced, because the Fed′s actions will result in higher interest rates.
C) increased, because the Fed′s actions will result in lower interest rates.
D) reduced, because the Fed′s actions will result in lower interest rates.
Answer: B

Topic: Policy Effects in the Goods and Money Markets

43) If the Fed accommodates a fiscal expansion by increasing the money supply so that the interest rate increases only a little, the crowding-out effect will
A) be zero.
B) increase.
C) decrease, but still be positive.
D) become infinitely large.
Answer: C

Topic: Policy Effects in the Goods and Money Markets

Refer to the information provided in Figure 12.5 below to answer the questions that follow.
Figure 12.5
44) Refer to Figure 12.5. As a result of an expansionary fiscal policy, the largest crowding-out effect occurs if the planned investment schedule (curve) is similar to the one in Panel ________.
A) A
B) B
C) C
D) D
Answer: C

Topic: Policy Effects in the Goods and Money Markets

45) Refer to Figure 12.5. Assume the current equilibrium output is $500 billion, the spending multiplier is 5, and the government increases purchases by $10 billion. If the new equilibrium output increases to $530 billion, most likely the planned investment schedule (curve) is similar to the one in Panel ________.
A) A
B) B
C) C
D) D
Answer: A

Topic: Policy Effects in the Goods and Money Markets

46) Refer to Figure 12.5. Assume the current equilibrium output is $500 billion, the spending multiplier is 5, and the government increased spending by $10 billion. If the new equilibrium output increased to $550 billion, most likely the planned investment schedule (curve) is similar to the one in Panel ________.
A) A
B) B
C) C
D) D
Answer: B

Topic: Policy Effects in the Goods and Money Markets

47) Which of the following actions is an example of an expansionary fiscal policy?
A) an increase in the discount rate
B) a decrease in defense spending
C) a sale of government securities in the open market
D) a decrease in net taxes.
Answer: D

Topic: Policy Effects in the Goods and Money Markets

48) Which of the following sequence of events occurs in response to an expansionary fiscal policy?
A) Aggregate output decreases, causing money demand to decrease, causing the interest rate to decrease and planned investment to increase.
B) Aggregate output decreases, causing money demand to increase, causing interest rates to increase and planned investment to decrease.
C) Aggregate output increases, causing money demand to increase, causing interest rates to increase and planned investment to decrease.
D) Aggregate output decreases, causing the demand for money to increase, causing interest rates to increase and planned investment to increase.
Answer: C

Topic: Policy Effects in the Goods and Money Markets

Refer to the information provided in Figure 12.6 below to answer the questions that follow.

Figure 12.6

49) Refer to Figure 12.6. After government purchases are reduced, the planned aggregate expenditure function may shift from C + I + G′ to $C + I' + G'$ because the reduction in output will cause
A) money supply to increase, the interest rate to decrease, and planned investment to increase.
B) money supply to decrease, the interest rate to decrease, and planned investment to increase.
C) money demand to decrease, the interest rate to decrease, and planned investment to increase.
D) money demand to increase, the interest rate to decrease, and planned investment to increase.
Answer: C

Topic: Policy Effects in the Goods and Money Markets

50) Refer to Figure 12.6. The initial aggregate expenditure function is given by $C + I + G$. A decrease in government spending shifts the aggregate expenditure function to $C + I + G'$. If investment does NOT depend on the interest rate, the multiplier
A) is .5.
B) is 1.33.
C) is 2.
D) cannot be determined from the information available.
Answer: C

Topic: Policy Effects in the Goods and Money Markets

51) Refer to Figure 12.6. If investment does NOT depend on the interest rate, the change in government purchases that decreases income from $400 billion to $100 billion is
A) an increase of $150 billion.
B) a decrease of $150 billion.
C) a decrease of $300 billion.
D) cannot be determined from the information available.
Answer: B

Topic: Policy Effects in the Goods and Money Markets

52) Refer to Figure 12.6. If investment DOES depend on the interest rate, the change in planned investment that the decrease in government spending brought about so that income fell from $400 billion to $200 billion rather than $100 billion would have been
A) an increase of $50 billion.
B) a decrease of $100 billion.
C) a decrease of $200 billion.
D) cannot be determined from the information available.
Answer: A

Topic: Policy Effects in the Goods and Money Markets

Refer to the information provided in Figure 12.7 below to answer the questions that follow.
Figure 12.7
53) Refer to Figure 12.7. What is the multiplier in this economy?
A) 2
B) 4
C) 5
D) 10
Answer: A

Topic: Policy Effects in the Goods and Money Markets

54) Refer to Figure 12.7. The initial aggregate expenditures are represented by the line *AE*0. If the government increases spending by $100 billion and the aggregate expenditures curve shifts to *AE*1, we know for sure that
A) there is $100 billion decline in planned investment.
B) there is total crowding-out effect.
C) the planned investment schedule is vertical.
D) the planned investment schedule is downward sloping.
Answer: D

Topic: Policy Effects in the Goods and Money Markets

55) Refer to Figure 12.7. The initial aggregate expenditures are represented by the line *AE*0. If the government increases spending by $100 billion and the aggregate expenditures curve shifts to *AE*2, we know for sure that

A) the interest rate does not change as a result of fiscal policy.
B) planned investment is perfectly insensitive to changes in the interest rate.
C) there is total crowding-out effect.
D) the planned investment schedule is horizontal.
Answer: B

Topic: Policy Effects in the Goods and Money Markets

56) Refer to Figure 12.7. The initial aggregate expenditures are represented by the line *AE*0. If the government increases spending by $100 billion and the aggregate expenditures curve remains *AE*0, we know for sure that
A) the interest rate does not change as a result of fiscal policy.
B) planned investment is perfectly insensitive to changes in the interest rate.
C) there is total crowding-out effect.
D) the planned investment schedule is downward sloping.
Answer: C

Topic: Policy Effects in the Goods and Money Markets

57) If investment depends on the interest rate, a decrease in net taxes will cause aggregate output to ________ than if investment doesn′t depend on the interest rate.
A) increase by more
B) increase by less
C) decrease by more
D) decrease by less
Answer: B

Topic: Policy Effects in the Goods and Money Markets

58) A decrease in the money supply aimed at decreasing aggregate output is
A) an expansionary fiscal policy.
B) a contractionary monetary policy.
C) a contractionary fiscal policy.
D) an expansionary monetary policy.
Answer: B

Topic: Policy Effects in the Goods and Money Markets

59) Which of the following is the sequence of events following a contractionary monetary policy?
A) Money demand increases ⇒ interest rates increase ⇒ planned investment falls and aggregate output falls.
B) Interest rates increase ⇒ planned investment decreases ⇒ aggregate output decreases ⇒ money demand decreases.
C) Interest rates decrease ⇒ planned investment decreases ⇒ aggregate output decreases ⇒money demand decreases.
D) Aggregate output falls ⇒ the demand for money falls ⇒ interest rates rises ⇒ planned investment decreases.
Answer: B

Topic: Policy Effects in the Goods and Money Markets

Refer to the information provided in Figure 12.8 below to answer the questions that follow.
Figure 12.8

60) Refer to Figure 12.8. Interest rate *r* 1 is greater than interest rate *r* 0 . Which of the following would have caused the planned aggregate expenditure function to shift from *C* + *I* +*G* to *C* + *I′* + *G*?
A) a contractionary monetary policy
B) a contractionary fiscal policy
C) a decrease in the cost of capital relative to labor
D) an expansionary monetary policy
Answer: A

Topic: Policy Effects in the Goods and Money Markets

61) Which of the following actions is an example of an expansionary monetary policy?
A) a reduction in federal spending on education
B) a purchase of government securities in the open market
C) an increase in the discount rate
D) an increase in income tax rates
Answer: B

Topic: Policy Effects in the Goods and Money Markets

62) If you are concerned that the inflation rate is too high, which of the following policies would you recommend?
A) a decrease in the money supply
B) an increase in the money supply
C) a decrease in income tax rates
D) an increase in government spending
Answer: A

Topic: Policy Effects in the Goods and Money Markets

63) The combination of monetary and fiscal policies in use at a given time is referred to as the
A) crowding-out mix.
B) policy mix.
C) discretionary mix.
D) package mix.
Answer: B

Topic: Policy Effects in the Goods and Money Markets

64) A policy mix that consists of a contractionary fiscal policy and an expansionary monetary policy would
A) be neutral with respect to the composition of aggregate spending in the economy.
B) lead to higher interest rates.
C) favor government spending over investment spending.
D) favor investment spending over government spending.
Answer: D

Topic: Policy Effects in the Goods and Money Markets

65) A policy mix that consists of an expansionary fiscal policy and a contractionary monetary policy would
A) be neutral with respect to the composition of aggregate spending in the economy.
B) favor investment spending over government purchases.
C) lead to lower interest rates.
D) favor government purchases over investment spending.
Answer: D

Topic: Policy Effects in the Goods and Money Markets

66) A policy mix of an expansionary fiscal policy and a contractionary monetary policy would cause
A) output to decrease and interest rates to decrease.
B) output to decrease and interest rates to increase.
C) output to decrease and interest rates to either increase, decrease, or remain unchanged.
D) output to either increase, decrease, or remain unchanged and interest rates to increase.
Answer: D

Topic: Policy Effects in the Goods and Money Markets

67) A policy mix of an expansionary fiscal policy and an expansionary monetary policy would cause output to ________ and interest rates to ________.
A) increase; increase
B) increase; increase, decrease, or remain unchanged
C) increase, decrease, or remain unchanged; increase
D) decrease; increase
Answer: B

Topic: Policy Effects in the Goods and Money Markets

68) The policy mix of a contractionary fiscal policy and a contractionary monetary policy would cause output to ________, and interest rates to ________.
A) decrease; increase, decrease, or remain unchanged
B) decrease; decrease
C) decrease; increase
D) increase, decrease, or remain unchanged; decrease
Answer: A

Topic: Policy Effects in the Goods and Money Markets

69) The policy mix that would cause the interest rate to increase and investment to decrease, but have an indeterminate effect on aggregate output, is a mix of
A) expansionary fiscal policy and expansionary monetary policy.
B) contractionary fiscal policy and expansionary monetary policy.
C) expansionary fiscal policy and contractionary monetary policy.
D) contractionary fiscal policy and contractionary monetary policy.
Answer: C

Topic: Policy Effects in the Goods and Money Markets

70) The policy mix that would cause the interest rate to decrease and investment to increase, but have an indeterminate effect on aggregate output, is a mix of
A) contractionary fiscal policy and expansionary monetary policy.
B) expansionary fiscal policy and contractionary monetary policy.
C) expansionary fiscal policy and expansionary monetary policy.
D) contractionary fiscal policy and contractionary monetary policy.
Answer: A

Topic: Policy Effects in the Goods and Money Markets

71) If the Fed increases the money supply, there will initially be
A) a surplus of money and the equilibrium interest rate will rise.
B) a surplus of money and the equilibrium interest rate will fall.
C) a shortage of money and the equilibrium interest rate will rise.
D) a shortage of money and the equilibrium interest rate will fall.
Answer: B

Topic: Policy Effects in the Goods and Money Markets

72) If the Fed decreases the money supply, there will initially be
A) a shortage of money and the equilibrium interest rate will rise.
B) a shortage of money and the equilibrium interest rate will fall.
C) a surplus of money and the equilibrium interest rate will rise.
D) a surplus of money and the equilibrium interest rate will fall.
Answer: A

Topic: Policy Effects in the Goods and Money Markets

73) If GDP increases, there will initially be
A) a shortage of money and the equilibrium interest rate will rise.
B) a shortage of money and the equilibrium interest rate will fall.
C) a surplus of money and the equilibrium interest rate will rise.
D) a surplus of money and the equilibrium interest rate will fall.
Answer: A

Topic: Policy Effects in the Goods and Money Markets

74) If GDP decreases, there will initially be
A) a surplus of money and the equilibrium interest rate will rise.
B) a surplus of money and the equilibrium interest rate will fall.
C) a shortage of money and the equilibrium interest rate will rise.
D) a shortage of money and the equilibrium interest rate will fall.
Answer: B

Topic: Policy Effects in the Goods and Money Markets

2 True/False
1) Fiscal policy affects the money market through its impact on income and money demand.
Answer: TRUE

Topic: Policy Effects in the Goods and Money Markets

2) Monetary policy affects the goods market through its impact on the interest rate and planned investment.
Answer: TRUE

Topic: Policy Effects in the Goods and Money Markets

3) The tendency for increases in government purchases to cause reductions in private saving is known as the crowding-out effect.
Answer: FALSE

Topic: Policy Effects in the Goods and Money Markets

4) As the interest sensitivity of investment demand increases, the size of the crowding-out effect increases.
Answer: TRUE

Topic: Policy Effects in the Goods and Money Markets

5) If planned investment falls as the interest rate rises, there will be no crowding-out effect.
Answer: FALSE

Topic: Policy Effects in the Goods and Money Markets

6) The more sensitive planned investment is to the interest rate, the less effective fiscal policy.
Answer: TRUE

Topic: Policy Effects in the Goods and Money Markets

7) The more sensitive planned investment is to the interest rate, the less the effectiveness of monetary policy.
Answer: FALSE

Topic: Policy Effects in the Goods and Money Markets

8) If the Fed wants to reduce the inflation rate, it should lower the discount rate.
Answer: FALSE

Topic: Policy Effects in the Goods and Money Markets

9) If the Fed wants to reduce the inflation rate, it should sell bonds in the open market.
Answer: TRUE

Topic: Policy Effects in the Goods and Money Markets

10) The policy mix of a contractionary monetary policy and a contractionary fiscal policy will, unambiguously, lead to a decrease in the interest rate.
Answer: FALSE

Topic: Policy Effects in the Goods and Money Markets

12.4 The Aggregate Demand (AD) Curve

1 Multiple Choice

1) In an economy, when the price level falls, consumers and firms buy more goods and services.This relationship is represented by the
A) aggregate expenditures curve.
B) aggregate demand curve.
C) short-run aggregate supply curve.
D) long-run aggregate supply curve.
Answer: B

2) The aggregate demand curve shows a ________ relationship between ________ and total quantity of output ________.
A) positive; the interest rate; demanded B) negative; the price level; supplied
C) positive; the price level; demanded D) negative; the price level; demanded
Answer: D

3) The aggregate demand curve shows that, ceteris paribus,
A) at higher price levels, total quantity of output demanded is higher.
B) at lower price levels, total quantity of output supplied is lower.
C) at lower price levels, total quantity of output demanded is higher.
D) at higher price levels, total quantity of output supplied is lower.
Answer: C

368
4) The aggregate demand curve
A) is an upward sloping curve. B) is a downward sloping curve.
C) may slope upward or downward. D) is horizontal.
Answer: B

5) Money demand is a function of all of the following EXCEPT
A) interest rate. B) price level.
C) money supply. D) aggregate output.
Answer: C

6) The quantity of aggregate output demanded will fall if
A) the interest rate is reduced. B) the price level increases.
C) the money supply is increased. D) net taxes are reduced.
Answer: B

369

Refer to the information provided in Figure 12.10 below to answer the questions that follow.
Figure 12.10
7) Refer to Figure 12.10. The money demand curve will shift from *M*d0
to *M*d1
, if
A) the price level decreases. B) the interest rate decreases.
C) the level of aggregate output increases. D) the inflation rate increases.
Answer: A

8) Refer to Figure 12.10. If the money demand curve shifts from *M*d0
to *M*d1
,
A) planned investment will decrease and aggregate output will decrease.
B) planned investment will decrease and aggregate output will increase.
C) planned investment will increase and aggregate output will decrease.
D) planned investment will increase and aggregate output will increase.
Answer: D

9) Which of the following sequence of events is TRUE?
A) $P\uparrow \Rightarrow Md\downarrow \Rightarrow r\uparrow$ B) $P\uparrow \Rightarrow Md\uparrow \Rightarrow r\downarrow$
C) $Y\uparrow \Rightarrow Md\downarrow \Rightarrow r\uparrow$ D) $Y\uparrow \Rightarrow Md\uparrow \Rightarrow r\uparrow$
Answer: D

370
10) As the price level in the economy increases, which of the following sequence of events occurs?
A) Md↑ ⇒ r↑ ⇒ I↑ ⇒ AE↓ B) Md↓ ⇒ r↑ ⇒ I↑ ⇒ AE↑
C) Md↑ ⇒ r↑ ⇒ I↓ ⇒ AE↓ D) Md↓ ⇒ r↑ ⇒ I↓ ⇒ AE↓
Answer: C

11) As the price level in the economy decreases, which of the following sequence of events occurs?
A) Md↓ ⇒ r↑ ⇒ AD↓ B) Md↑ ⇒ r↑ ⇒ AD↑
C) Md↓ ⇒ r↓ ⇒ AD↓ D) Md↓ ⇒ r↓ ⇒ AD↑
Answer: D

12) Aggregate demand rises when the price level decreases because the lower price level causes
A) the market demand for all goods and services to decrease.
B) the supply of money to decrease.
C) the demand for money to rise causing interest rates to fall.
D) the demand for money to fall causing interest rates to fall.
Answer: D

13) Aggregate demand decreases when the price level rises because the higher price level
A) means that people can afford to buy more goods.
B) causes the demand for money to increase, causing interest rates to rise.
C) means that the prices of some goods fall relative to the prices of other goods.
D) causes the interest rate to fall.
Answer: B

14) Which of the following statements is TRUE?
A) The aggregate demand curve is the sum of all market demand curves in the economy.
B) Each point on the aggregate demand curve corresponds to a point at which both the goods market and the money market are in equilibrium.
C) The aggregate demand curve is a market demand curve.
D) Only the goods market is in equilibrium at each point on the aggregate demand curve.
Answer: B

371
15) An increase in the money supply will cause planned investment to ________ and consumption to ________.
A) decrease; decrease B) decrease; increase
C) increase; increase D) increase; decrease
Answer: C

16) The level of aggregate output demanded falls when the price level rises, because the resulting increase in the interest rate will lead to
A) higher investment spending and higher consumption spending.
B) lower investment spending and higher consumption spending.
C) higher investment spending and lower consumption spending.
D) lower investment spending and lower consumption spending.
Answer: D

17) The aggregate demand curve slopes downward because at higher price level
A) the purchasing power of consumers′ assets declines and consumption increases.
B) producers can get more for what they produce, and they increase production.
C) the purchasing power of consumers′ assets declines and consumption decreases.
D) the purchasing power of consumers′ assets increases and consumption increases.
Answer: C

18) When changes in the price level cause changes in the interest rate and, thus, changes in aggregate output demanded, we call this effect
A) the multiplier effect. B) the real wealth effect.
C) the real income effect. D) the consumption link.
Answer: D

19) When the general price level rises,
A) consumption falls as a result of the real wealth effect.
B) consumption increases as a result of the multiplier effect.
C) investment rises as a result of the real wealth effect.
D) investment rises as a result of the multiplier effect.
Answer: A

372

20) The change in consumption brought about by a change in purchasing power of savings that results from a change in the price level is the

A) consumption effect. B) money supply effect.
C) real wealth effect. D) interest rate effect.
Answer: C

21) At every point along the aggregate demand curve, the level of aggregate output demanded is
A) greater than planned aggregate expenditure.
B) less than planned aggregate expenditure.
C) equal to planned aggregate expenditure.
D) unrelated to the concept of planned aggregate expenditure.
Answer: C

22) At every point along the aggregate demand curve (assuming no foreign sector),
A) $G = T$. B) $S = I$. C) $Y = C$. D) $Y = C + I + G$.
Answer: D

23) A decrease in the quantity of money supplied at a given price level causes
A) no change in aggregate demand. B) a decrease in aggregate demand.
C) an increase in aggregate demand. D) an increase in aggregate supply.
Answer: B

24) When the quantity of money supplied decreases, at a given price level
A) the aggregate demand curve shifts leftward.
B) the aggregate demand curve shifts rightward.
C) the economy moves along the aggregate demand curve.
D) the aggregate demand does not change.
Answer: A

373
25) An increase in government purchases shifts the ________ curve to the ________.
A) aggregate demand; left B) aggregate supply; left
C) aggregate demand; right D) aggregate supply; right
Answer: C

26) The aggregate demand curve would shift to the left if
A) government spending were increased. B) net taxes were increased.
C) the money supply were increased. D) the cost of energy were to decrease.
Answer: B

27) A decrease in net taxes at a given price level leads to
A) no change in aggregate demand. B) an increase in aggregate demand.
C) a decrease in aggregate demand. D) a decrease in aggregate supply.
Answer: B

28) A rightward shift in the aggregate demand curve can be caused by
A) a decrease in government spending. B) an increase in taxes.
C) a decrease in money supply. D) the Fed buying government bonds.
Answer: D

29) The aggregate demand shifts to the left if
A) the government increases spending.
B) the Fed sells government bonds.
C) the government decreases taxes.
D) the Fed decreases the required reserve ratio.
Answer: B

374
30) The aggregate demand increases, if
A) the government increases spending. B) the Fed sells government bonds.
C) the government increases taxes. D) the Fed raises the discount rate.
Answer: A

31) The aggregate demand increases, if
A) the government decreases spending.
B) the Fed sells government bonds.
C) the government decreases taxes.
D) the Fed increases the required reserve ratio.
Answer: C

32) The aggregate demand curve increases if
A) the Fed increase the discount rate.
B) the Fed buys government bonds.
C) the Fed increases the required reserve ratio.
D) the government increases taxes.
Answer: B

375
Refer to the information provided in Figure 12.11 below to answer the questions that follow.
Figure 12.11
33) Refer to Figure 12.11. An aggregate demand shift from *AD*2 to *AD*0 can be caused by
A) a decrease in the price level. B) an increase in the price level.
C) a decrease in taxes. D) a decrease in money supply.
Answer: C

34) Refer to Figure 12.11. An aggregate demand shift from *AD*1 to *AD*0 can be caused by
A) a decrease in government spending. B) an increase in money supply.
C) a decrease in the price level. D) an increase in the price level.
Answer: A

35) Refer to Figure 12.11. Suppose the economy is at Point *A*, an increase in the price level can cause a movement to Point
A) *E*. B) *B*. C) *C*. D) *D*.
Answer: A

36) Refer to Figure 12.11. Suppose the economy is at Point *A*, a decrease in the price level can cause a movement to Point
A) *E*. B) *B*. C) *C*. D) *D*.
Answer: D

376
37) Refer to Figure 12.11. Suppose the economy is at Point *A*, a decrease in taxes can cause a movement to Point
A) *E*. B) *B*. C) *C*. D) *D*.
Answer: B

38) Refer to Figure 12.11. Suppose the economy is at Point *A*, an increase in money demand could cause a movement to Point
A) *E*. B) *B*. C) *C*. D) *D*.
Answer: C

39) Refer to Figure 12.11. Suppose the economy is at Point *A*, an decrease in government purchases can cause a movement to Point
A) *E*. B) *B*. C) *C*. D) *D*.
Answer: C

40) Refer to Figure 12.11. Suppose the economy is at Point A an increase in government purchases can cause a movement to Point
A) *E*. B) *B*. C) *C*. D) *D*.
Answer: B

2 True/False
1) The aggregate demand curve is the sum of all demand curves of all goods and services in the economy.
Answer: FALSE

2) The wealth effect explains why the aggregate supply curve is horizontal in the long run.
Answer: FALSE

377
3) A higher interest rate increases both planned investment and consumption spending.
Answer: FALSE

4) A decrease in net taxation increases aggregate demand.
Answer: TRUE

5) A decrease in the price level raises the real value of wealth.
Answer: TRUE

6) An increase in the supply of money will shift the aggregate demand curve to the right.
Answer: TRUE

7) A decrease in government spending shifts aggregate demand to the left.
Answer: TRUE

8) The aggregate demand curve shows that at higher price levels the total quantity of output demanded is greater.
Answer: FALSE

9) If the Fed buys government securities, it decrease the money supply and aggregate demand.
Answer: FALSE

378
10) An increase in the price level cause aggregate demand to increase .
Answer: FALSE

12.5 Appendix: The IS-LM Diagram
1 Multiple Choice
1) Each point on the *LM* curve represents the equilibrium point in the
A) goods market for the given interest rate.
B) money market for the given value of aggregate output.
C) goods market for the given level of government spending.
D) money market for the given level of the money supply.
Answer: B

Topic: Appendix: The IS-LM Diagram

Refer to the information provided in Figure 12.9 below to answer the questions that follow.
Figure 12.9
2) Refer to Figure 12.9. An expansionary fiscal policy shifts the ________ curve to the ________.
A) *IS*; left B) *LM*; right C) *IS*; right D) *LM*; left
Answer: C

Topic: Appendix: The IS-LM Diagram

379
3) Refer to Figure 12.9. A contractionary monetary policy shifts the ________ curve to the ________.
A) *LM*; right B) *IS*; right C) *IS*; left D) *LM*; left
Answer: D

Topic: Appendix: The IS-LM Diagram

4) Refer to Figure 12.9. As a result of ________, the equilibrium interest rate increases and the equilibrium output level increases.
A) an expansionary monetary policy B) a contractionary monetary policy
C) an expansionary fiscal policy D) a contractionary fiscal policy
Answer: C

Topic: Appendix: The IS-LM Diagram

5) Refer to Figure 12.9. As a result of ________, the equilibrium interest rate increases and the equilibrium output level decreases.
A) an expansionary monetary policy B) a contractionary monetary policy
C) an expansionary fiscal policy D) a contractionary fiscal policy
Answer: B

Topic: Appendix: The IS-LM Diagram

6) Refer to Figure 12.9. Which policy mix would definitely increase the equilibrium interest rate?
A) An expansionary monetary policy and an expansionary fiscal policy
B) A contractionary monetary policy and a contractionary fiscal policy
C) An expansionary fiscal policy and a contractionary monetary policy
D) An expansionary monetary policy and a contractionary fiscal policy
Answer: C

Topic: Appendix: The IS-LM Diagram

7) Each point on the *IS* curve represents the equilibrium point in the
A) goods market for the given level of government spending.
B) money market for the given value of aggregate output.
C) goods market for the given interest rate.
D) money market for the given level of the money supply.
Answer: C

Topic: Appendix: The IS-LM Diagram

380
8) If the combination *r* = 10% and *Y* = $200 billion is on the *IS* curve, we know that the combination *r* = 10% and *Y* = $300 billion consists of an
A) output level that is too high to maintain equilibrium in the goods market with an interest rate of 10%.
B) interest rate that is too high to maintain equilibrium in the money market with an output of $300 billion.
C) interest rate that is too low to maintain equilibrium in the goods market with an output of $300 billion.
D) output level that is too low to maintain equilibrium in the goods market with an interest rate of 10%.
Answer: A

Topic: Appendix: The IS-LM Diagram

9) The curve that illustrates the positive relationship between the equilibrium values of aggregate output and the interest rate in the money market is the

A) money demand curve. B) money supply curve.
C) *LM* curve. D) *IS* curve.
Answer: C

Topic: Appendix: The IS-LM Diagram

10) If the combination *r* = 5% and *Y* = $100 billion is on the *LM* curve, we know that the combination *r* = 7% and *Y* = $100 billion consists of an
A) output level that is too high to maintain equilibrium in the money market with an interest rate of 7%.
B) interest rate that is too high to maintain equilibrium in the money market with an output of $100 billion.
C) interest rate that is too low to maintain equilibrium in the goods market with an output of $100 billion.
D) output level that is too low to maintain equilibrium in the goods market with an interest rate of 7%.
Answer: B
Topic: Appendix: The IS-LM Diagram

2 True/False
1) The IS curve shows combinations of income and interest rates consistent with equilibrium in the money market.
Answer: FALSE
Topic: Appendix: The IS-LM Diagram

381
2) If the money supply decreases, then the LM curve decreases.
Answer: TRUE
Topic: Appendix: The IS-LM Diagram

3) If government spending increases, then the IS curve increases.
Answer: TRUE
Topic: Appendix: The IS-LM Diagram

4) If net taxes decrease, then the IS curve rises.
Answer: TRUE
Topic: Appendix: The IS-LM Diagram

5) Expansionary fiscal policy decreases the IS curve.
Answer: FALSE
Topic: Appendix: The IS-LM Diagram