

Chapter 20

The ISLM Model

20.1 Determination of Aggregate Output

1) His analysis started with the recognition that the total quantity demanded of an economy's output was the sum of four types of spending: consumer expenditure, planned investment spending, government spending, and net exports.

- A) John Maynard Keynes
- B) Sir John Hicks
- C) Milton Friedman
- D) Paul A. Samuelson

Answer: A

Ques Status: Previous Edition

2) Keynes's motivation in developing the aggregate output determination model stemmed from his concern with explaining

- A) the hyperinflations of the 1920s.
- B) why the Great Depression occurred.
- C) the high unemployment in Great Britain before World War I.
- D) the high unemployment in Great Britain after World War II.

Answer: B

Ques Status: Previous Edition

3) Keynes was especially interested in explaining movements of _____ because he wanted to explain why the Great Depression had occurred and how government policy could be used to increase _____ in a similar economic situation.

- A) aggregate output; wages
- B) aggregate output; employment
- C) wage rates; wages
- D) wage rates; employment

Answer: B

Ques Status: Previous Edition

- 4) Keynes was especially concerned with explaining the
- A) recession of 1920–21.
 - B) low levels of output and employment during the Great Depression.
 - C) strong economic growth of the 1920s.
 - D) high unemployment in Great Britain during the 1920s.

Answer: B

Ques Status: Revised

- 5) Keynes was especially concerned with explaining the _____ level of output and employment during the _____.
- A) low; 1920s
 - B) low; 1930s
 - C) high; 1920s
 - D) high; 1930s

Answer: B

Ques Status: Previous Edition

- 6) In the simple Keynesian model, equilibrium aggregate output is determined by
- A) aggregate demand.
 - B) aggregate supply.
 - C) the national demand for labor.
 - D) the price level

Answer: A

Ques Status: Revised

- 7) Keynes argued that the sum of the components that comprise aggregate demand
- A) could add up to an output smaller than the economy is capable of producing, thus resulting in less than full employment.
 - B) could add up to an output greater than the economy is capable of producing, thus resulting in less than full employment.
 - C) always equaled the output the economy is capable of producing.
 - D) equaled the output the economy is capable of producing by definition.

Answer: A

Ques Status: Previous Edition

- 8) In the simple Keynesian model of aggregate output determination, an equilibrium level of output below that necessary to maintain full employment can be explained by
- A) minimum wage laws.
 - B) a generous level of unemployment benefits.
 - C) relatively low aggregate demand.
 - D) relatively high prices.

Answer: C

Ques Status: Revised

- 9) Under Keynesian analysis, aggregate demand can be written as
- A) $Y^{ad} = C + I + G + NX$
 - B) $Y^{ad} = C + I + G - NX$
 - C) $Y^{ad} = C - I - G - NX$
 - D) $Y^{ad} = C + I - G - NX$

Answer: A

Ques Status: New

- 10) The simple Keynesian model illustrates the idea that the economy can come to rest at a level of aggregate output
- A) only at the full employment level.
 - B) below the full employment level.
 - C) only when the price level is fixed.
 - D) only when wages are stable.

Answer: B

Ques Status: Previous Edition

- 11) Keynes believed that an economy could attain an equilibrium level of output
- A) only at the full-employment level of output.
 - B) below the full-employment level of output.
 - C) only if the government took a "hands off" approach.
 - D) only if prices were falling.

Answer: B

Ques Status: Revised

- 12) Which of the following statements concerning Keynesian analysis is false?
- A) Keynes's analysis started with the recognition that the total quantity demanded of an economy's output was the sum of four types of spending: consumer expenditure, planned investment spending, government spending, and net exports.
 - B) Keynes recognized that equilibrium would occur in the economy when total quantity of output supplied equals quantity of output demanded (Y^{ad}), that is, when $Y = Y^{ad}$.
 - C) Keynes's analysis involves explaining why aggregate output is at a certain level by understanding what factors affect each component of aggregate demand and how the sum of these components could add up to an output smaller than the economy is capable of producing, resulting in less than full employment.
 - D) Keynes's analysis explains how the price level will change when the total quantity of output supplied changes.

Answer: D

Ques Status: Revised

- 13) Which of the following statements concerning Keynesian analysis are true?
- A) Keynes's analysis started with the recognition that the total quantity demanded of an economy's output was the sum of four types of spending: consumer expenditure, planned investment spending, federal government spending, and state and local government spending.
 - B) Keynes recognized that equilibrium would occur in the economy when total quantity of output supplied (aggregate output produced) equals quantity of output demanded (Y^{ad}), that is, when $Y = Y^{ad}$.
 - C) Keynes's analysis involves explaining why wage rates are at a certain level by understanding what factors affect labor demand and why this could cause output to be greater than the economy is capable of producing, resulting in high inflation.
 - D) Keynes's analysis explains how the price level will change when the total quantity of output supplied changes.

Answer: B

Ques Status: Revised

- 14) Because inflation was not a serious problem during the Great Depression, Keynes's analysis assumed
- A) that unemployment also was not a problem.
 - B) that the money supply was fixed.
 - C) that the price level was fixed.
 - D) that monetary policy is not effective.

Answer: C

Ques Status: Revised

15) Keynes reasoned that consumer expenditure is most closely related to

- A) the level of interest rates.
- B) the price level.
- C) disposable income.
- D) the marginal tax rate.

Answer: C

Ques Status: Previous Edition

16) In the Keynesian model of income determination, consumer expenditure includes spending by

- A) consumers on personal computers.
- B) businesses on personal computers.
- C) governments on personal computers.
- D) foreigners on domestic personal computers.

Answer: A

Ques Status: Revised

17) The marginal propensity to consume (mpc) can be defined as the fraction of

- A) a change in income that is spent.
- B) a change in income that is saved.
- C) income that is spent.
- D) income that is saved.

Answer: A

Ques Status: Previous Edition

18) If the consumption function is expressed as $C = a + mpc \times Y_D$, then "mpc" represents

- A) autonomous consumer expenditure.
- B) the marginal propensity to consume.
- C) the expenditure multiplier.
- D) disposable income.

Answer: B

Ques Status: Previous Edition

19) If the consumption function is expressed as $C = a + mpc \times Y_D$, then "a" represents

- A) autonomous consumer expenditure.
- B) the marginal propensity to consume.
- C) the expenditure multiplier.
- D) disposable income.

Answer: A

Ques Status: Previous Edition

20) If the consumption function is $C = 20 + 0.5Y_D$, then an increase in disposable income by \$100 will result in an increase in consumer expenditure by

- A) \$25.
- B) \$70.
- C) \$50.
- D) \$100.

Answer: C

Ques Status: Revised

21) If the consumption function is $C = 20 + 0.8Y_D$, then an increase in disposable income by \$100 will result in an increase in consumer expenditure by

- A) \$58.
- B) \$64.
- C) \$80.
- D) \$100.

Answer: C

Ques Status: Revised

22) Assume that autonomous consumption equals \$200 and that the mpc equals 0.8. If disposable income equals \$1000, then total consumption equals

- A) \$80
- B) \$200
- C) \$800
- D) \$1000

Answer: D

Ques Status: New

23) Assume that autonomous consumption equals \$200 and disposable income equals \$1000. If total consumption equal \$800, then the mpc equals

- A) 0.2
- B) 0.6
- C) 0.8
- D) 1.0

Answer: B

Ques Status: New

24) Assume that disposable income equals \$1000 and the mpc equals 0.6. If total consumption equal \$800, then autonomous consumption is equal to

- A) \$0
- B) \$200
- C) \$800
- D) \$1000

Answer: B

Ques Status: New

25) Everything else held constant, if total consumption increases from \$600 to \$800 because of an increase of disposable income of \$400, then the mpc is equal to

- A) 0.2
- B) 0.4
- C) 0.5
- D) 0.6

Answer: C

Ques Status: New

26) Everything else held constant, if consumption expenditure increases by 65 for a 100 increase in disposable income, the mpc is

- A) 0.
- B) 0.5.
- C) 0.65.
- D) 1.

Answer: C

Ques Status: Revised

27) Everything else held constant, if disposable income increases by 200 and consumption expenditure increases by 150, the mpc is

- A) 0.
- B) 0.15.
- C) 0.5.
- D) 0.75.

Answer: D

Ques Status: Revised

28) Everything else held constant, if consumption expenditure falls by 160 when disposable income falls by 200, the mpc is

- A) 0.
- B) 0.2.
- C) 0.4.
- D) 0.8.

Answer: D

Ques Status: Revised

29) Economists define investment as the purchase of

- A) a new physical asset such as a new machine or a new house.
- B) any physical asset, whether new or not, used by business to increase production.
- C) any physical asset used by business to increase production and the repurchase of common stock.
- D) business spending on capital and household spending on durable goods.

Answer: A

Ques Status: Previous Edition

30) Actual investment spending is comprised of two components:

- A) fixed investment and actual inventory investment.
- B) planned investment and fixed investment.
- C) unplanned investment and inventory investment.
- D) fixed business investment and fixed housing investment.

Answer: A

Ques Status: Previous Edition

- 31) Planned investment spending, a component of aggregate demand, is equal to
- A) fixed investment plus actual inventory investment.
 - B) fixed investment plus unplanned inventory investment.
 - C) fixed investment.
 - D) fixed investment plus planned inventory investment.

Answer: D

Ques Status: Previous Edition

- 32) There are two types of investment: _____ investment—the spending by business firms on equipment and structures, and planned spending on residential houses—and _____ investment—spending by business firms on additional holdings of raw materials, parts, and finished goods.
- A) planned; gross
 - B) planned; inventory
 - C) fixed; gross
 - D) fixed; inventory

Answer: D

Ques Status: Previous Edition

- 33) A fall in inventories is synonymous with _____ investment.
- A) negative fixed
 - B) positive fixed
 - C) positive inventory
 - D) negative inventory

Answer: D

Ques Status: Revised

- 34) A difference between inventory investment and fixed investment is that
- A) fixed investment is never unplanned.
 - B) fixed investment is never planned.
 - C) inventory investment is never unplanned.
 - D) unplanned inventory investment is always zero.

Answer: A

Ques Status: Revised

- 35) In the Keynesian cross diagram, the point at which the aggregate demand function crosses the 45 degree line indicates the
- A) level of full employment income.
 - B) natural level of income.
 - C) equilibrium level of income.
 - D) autonomous level of income.

Answer: C

Ques Status: Previous Edition

- 36) Keynes mentioned two factors that influenced planned investment spending:
- A) interest rates and disposable income.
 - B) interest rates and business expectations about the future.
 - C) disposable income and business expectations about the future.
 - D) interest rates and business expectations about inflation.

Answer: B

Ques Status: Previous Edition

- 37) Aggregate demand in an economy with no government or foreign trade is
- A) consumer expenditure plus actual investment.
 - B) consumer expenditure plus planned investment.
 - C) consumer expenditure plus inventory investment.
 - D) consumer expenditure plus fixed investment.

Answer: B

Ques Status: Previous Edition

- 38) It is convenient to separate actual investment into two categories when explaining how the equilibrium level of aggregate output is determined. These two categories are _____ investment and _____ investment.
- A) planned; fixed
 - B) financial; structural
 - C) planned; unplanned
 - D) planned; structural

Answer: C

Ques Status: Revised

39) If unplanned investment is positive, firms will _____ production and output will _____.

- A) cut; rise
- B) cut; fall
- C) increase; rise
- D) increase; fall

Answer: B

Ques Status: Revised

40) If unplanned investment is negative, firms will _____ production and output will _____.

- A) cut; rise
- B) cut; fall
- C) increase; rise
- D) increase; fall

Answer: C

Ques Status: Revised

41) In the Keynesian framework, as long as output is below the equilibrium level, unplanned inventory investment will remain _____ and firms will continue to _____ production.

- A) negative; lower
- B) negative; raise
- C) positive; lower
- D) positive; raise

Answer: B

Ques Status: Previous Edition

42) In the Keynesian framework, as long as output is _____ the equilibrium level, unplanned inventory investment will remain _____ and firms will continue to raise production.

- A) below; negative
- B) above; negative
- C) below; positive
- D) above; positive

Answer: A

Ques Status: Previous Edition

- 43) In the Keynesian framework, as long as output is _____ the equilibrium level, unplanned inventory investment will remain _____ and firms will continue to lower production.
- A) below; negative
 - B) above; negative
 - C) below; positive
 - D) above; positive

Answer: D

Ques Status: Previous Edition

- 44) In the Keynesian framework, as long as output is _____ the equilibrium level, unplanned inventory investment will remain positive and firms will continue to _____ production.
- A) below; lower
 - B) above; lower
 - C) below; raise
 - D) above; raise

Answer: B

Ques Status: Previous Edition

- 45) In the Keynesian framework, as long as output is above the equilibrium level, unplanned inventory investment will remain _____ and firms will continue to _____ production.
- A) negative; lower
 - B) negative; raise
 - C) positive; lower
 - D) positive; raise

Answer: C

Ques Status: Previous Edition

- 46) In the Keynesian framework, as long as output is _____ the equilibrium level, unplanned inventory investment will remain negative and firms will continue to _____ production.
- A) below; lower
 - B) above; lower
 - C) below; raise
 - D) above; raise

Answer: C

Ques Status: Study Guide

47) In the Keynesian framework, as long as output is below the equilibrium level, unplanned inventory investment will remain negative, firms will continue to _____ production, and output will continue to _____.

- A) lower; fall
- B) lower; rise
- C) raise; fall
- D) raise; rise

Answer: D

Ques Status: Previous Edition

48) In the Keynesian framework, as long as output is _____ the equilibrium level, unplanned inventory investment will remain _____, firms will continue to raise production, and output will continue to rise.

- A) below; negative
- B) above; negative
- C) below; positive
- D) above; positive

Answer: A

Ques Status: Previous Edition

49) In the Keynesian framework, as long as output is _____ the equilibrium level, unplanned inventory investment will remain _____, firms will continue to lower production, and output will continue to fall.

- A) below; negative
- B) above; negative
- C) below; positive
- D) above; positive

Answer: D

Ques Status: Previous Edition

50) An increase in unplanned inventory investment for the entire economy equals the excess of

- A) output over aggregate supply.
- B) output over aggregate demand.
- C) aggregate supply over output.
- D) aggregate demand over output.

Answer: B

Ques Status: Revised

- 51) A decrease in unplanned inventory investment for the entire economy equals the excess of
- A) output over aggregate supply.
 - B) output over aggregate demand.
 - C) aggregate supply over output.
 - D) aggregate demand over output.

Answer: D

Ques Status: Revised

- 52) If aggregate demand is less than the level of aggregate output, then _____ inventory investment will be _____.
- A) planned; positive
 - B) actual; positive
 - C) actual; negative
 - D) planned; negative

Answer: B

Ques Status: Revised

- 53) If aggregate demand falls short of current output, business firms will _____ production to _____ inventories.
- A) cut; keep from accumulating
 - B) expand; keep from accumulating
 - C) cut; build up
 - D) expand; build up

Answer: A

Ques Status: Revised

- 54) If aggregated demand is less than actual output, unplanned inventory _____ will cause output to _____.
- A) accumulation; rise
 - B) depletion; fall
 - C) depletion; rise
 - D) accumulation; fall

Answer: D

Ques Status: Revised

55) If actual output is less than equilibrium output, firms will _____ output to keep from _____ inventories.

- A) increase; accumulating
- B) increase; depleting
- C) decrease; depleting
- D) decrease; accumulating

Answer: B

Ques Status: Previous Edition

56) If actual output is greater than equilibrium output, firms will _____ output to keep from _____ inventories.

- A) increase; accumulating
- B) increase; depleting
- C) decrease; depleting
- D) decrease; accumulating

Answer: D

Ques Status: Previous Edition

57) When the level of unplanned inventory investment is equal to zero, the economy is

- A) in disequilibrium.
- B) in a recession.
- C) in equilibrium.
- D) overheating

Answer: C

Ques Status: Revised

58) If aggregate demand equals output,

- A) the economy is in a recession.
- B) output will increase.
- C) output will fall.
- D) the economy is at its equilibrium level.

Answer: D

Ques Status: Previous Edition

Situation 20-1

Assume a closed economy with no government. Suppose that autonomous consumption equals \$400, planned investment equals \$500, and the mpc equals 0.9.

59) Using the information in Situation 20-1, if aggregate output is equal to \$10,000, then unplanned inventory investment equals

- A) -\$1000
- B) -\$100
- C) \$0
- D) \$100

Answer: D

Ques Status: New

60) Using the information in Situation 20-1, if aggregate output equals \$8,000, the unplanned inventory investment equals

- A) -\$100
- B) \$0
- C) \$100
- D) \$500

Answer: A

Ques Status: New

61) Using the information in Situation 20-1, the equilibrium level of aggregate output is

- A) \$900
- B) \$8,000
- C) \$9,000
- D) \$10,000

Answer: C

Ques Status: New

62) The expenditure multiplier is the ratio of the change in _____ to a change in the _____.

- A) equilibrium output; monetary base.
- B) the money supply; monetary base.
- C) the money supply; autonomous expenditure.
- D) equilibrium output; autonomous expenditure.

Answer: D

Ques Status: Revised

- 63) The ratio of the change in aggregate output to a change in planned investment spending is called
- A) the marginal propensity to consume.
 - B) autonomous consumer expenditure.
 - C) the expenditure multiplier.
 - D) unplanned inventory accumulation.

Answer: C

Ques Status: Previous Edition

- 64) The multiplier effect means that a given change in _____ expenditures will change equilibrium _____ by an amount _____ than the initial change in autonomous expenditures.
- A) autonomous; income; greater
 - B) autonomous; income; less
 - C) induced; income; greater
 - D) induced; income; less

Answer: A

Ques Status: Revised

- 65) If you know the value of the multiplier and the amount of a change in autonomous investment, you can calculate
- A) the change in the interest rate.
 - B) the change in the money supply.
 - C) the change in money demand.
 - D) the change in equilibrium output.

Answer: D

Ques Status: Revised

- 66) For a marginal propensity to consume of 0.75, the value of the multiplier is
- A) 0.25
 - B) 3.00
 - C) 3.75
 - D) 4.00.

Answer: D

Ques Status: Revised

67) If the marginal propensity to consume is .9, the value of the multiplier is

- A) 0.
- B) 1.
- C) 9.
- D) 10.

Answer: D

Ques Status: Revised

68) If the income multiplier is 2, the value of the marginal propensity to consume is

- A) 0.2.
- B) 0.5.
- C) 0.75.
- D) 1.

Answer: B

Ques Status: Revised

69) If the income multiplier is 4, the value of the marginal propensity to consume is

- A) 0.2.
- B) 0.5.
- C) 0.75.
- D) 1.

Answer: C

Ques Status: Revised

70) For every dollar increase in planned investment spending, aggregate output increases by _____.

- A) one dollar
- B) less than one dollar
- C) more than one dollar
- D) two dollars.

Answer: C

Ques Status: Revised

71) Keynes believed that changes in autonomous spending were dominated by changes in

- A) consumer expenditure.
- B) autonomous consumer expenditure.
- C) investment spending.
- D) taxes.
- E) none of the above.

Answer: C

Ques Status: Previous Edition

72) Keynes believed that changes in autonomous spending were dominated by unstable fluctuations in _____, which are influenced by emotional waves of optimism and pessimism—factors he referred to as "animal spirits."

- A) unplanned investment spending
- B) actual investment spending
- C) planned investment spending
- D) autonomous consumer expenditures

Answer: C

Ques Status: Revised

73) After witnessing the events in the Great Depression, Keynes took the view that an economy would continually suffer major output fluctuations because of the volatility of

- A) autonomous spending, particularly planned investment spending.
- B) induced spending, particularly consumer expenditures.
- C) autonomous spending, particularly consumer expenditures.
- D) autonomous spending, particularly government expenditures.

Answer: A

Ques Status: Previous Edition

Situation 20-1

Assume a closed economy with no government. Suppose that autonomous consumption equals \$400, planned investment equals \$500, and the mpc equals 0.9.

- 74) Using the information contained in Situation 20-1, if autonomous consumption increases by \$100, then equilibrium aggregate output will change by
- A) -\$1,000
 - B) -\$100
 - C) \$100
 - D) \$1,000

Answer: D

Ques Status: New

- 75) Using the information contained in Situation 20-1, if planned investment decreases by \$100, the equilibrium aggregate output will change by
- A) -\$1,000
 - B) \$-100
 - C) \$100
 - D) \$1,000

Answer: A

Ques Status: New

- 76) In the simple Keynesian framework, declines in planned investment spending that produce high unemployment can be offset by raising
- A) taxes.
 - B) government spending.
 - C) consumer confidence.
 - D) business confidence.

Answer: B

Ques Status: Previous Edition

- 77) The Keynesian framework indicates that government can play an important role in determining aggregate output by
- A) changing the level of government spending or taxes.
 - B) raising consumer confidence.
 - C) raising investor confidence.
 - D) changing the money supply and interest rates.

Answer: A

Ques Status: Previous Edition

78) A tax cut initially

- A) increases consumption expenditure by an amount greater than the tax cut.
- B) increases consumption expenditure by an amount equal to the tax cut.
- C) increases consumption expenditure by an amount that is less than the value of the tax cut.
- D) has no effect on consumption expenditure.
- E) reduces consumption expenditure by an amount that is less than the value of the tax cut.

Answer: C

Ques Status: Previous Edition

79) Assume equilibrium at full employment for an economy characterized by the simple Keynesian model. If the government raises taxes to eliminate a budget deficit, then

- A) the rate of unemployment will increase.
- B) the level of aggregate output will increase.
- C) the price level will increase.
- D) the rate of interest will fall.

Answer: A

Ques Status: Revised

Situation 20-2

Assume a closed economy. Suppose that autonomous consumption equals \$400, planned investment equals \$500, government expenditure equals \$200, net taxes equals \$50, and the mpc equals 0.9.

80) Using the information in situation 20-2, if government spending increases by \$100, then the equilibrium aggregate output will change by

- A) -\$1,000
- B) -\$100
- C) \$100
- D) \$1,000

Answer: D

Ques Status: New

81) Using the information in Situation 20-2, if taxes increase by \$10, then the equilibrium aggregate output will change by

- A) -\$90
- B) -\$10
- C) \$10
- D) \$90

Answer: A

Ques Status: New

82) Using the information in situation 20-2, if government increases their spending by \$50 and increases net taxes by 50, then equilibrium aggregate output will change by

- A) -\$100
- B) -\$50
- C) \$50
- D) \$100

Answer: C

Ques Status: New

83) In a closed economy, aggregate demand is the sum of

- A) consumer expenditure, actual investment spending, and government spending.
- B) consumer expenditure, planned investment spending, and government spending.
- C) consumer expenditure, actual investment spending, government spending, and net exports.
- D) consumer expenditure, planned investment spending, government spending, and net exports.

Answer: B

Ques Status: Previous Edition

84) In an open economy, aggregate demand is the sum of

- A) consumer expenditure, actual investment spending, and government spending.
- B) consumer expenditure, planned investment spending, and government spending.
- C) consumer expenditure, actual investment spending, government spending, and net exports.
- D) consumer expenditure, planned investment spending, government spending, and net exports.

Answer: D

Ques Status: Previous Edition

85) If net exports increase by 100 and the mpc is 0.75, equilibrium aggregate output increases by

- A) 100.
- B) 250.
- C) 400.
- D) 750.

Answer: C

Ques Status: Revised

86) If net exports increase by 250 and the mpc is 0.75, equilibrium aggregate output increases by

- A) 250.
- B) 500.
- C) 750.
- D) 1000.

Answer: D

Ques Status: Revised

87) If net exports decrease by 250 and the mpc is 0.75, equilibrium aggregate output

- A) increases by 1000.
- B) increases by 750.
- C) decreases by 750.
- D) decreases by 1000.

Answer: D

Ques Status: Revised

88) Aggregate output is _____ related to autonomous consumer expenditure, and is _____ related to planned investment spending.

- A) negatively; negatively
- B) negatively; positively
- C) positively; negatively
- D) positively; positively

Answer: D

Ques Status: Previous Edition

- 89) Aggregate output is _____ related to autonomous consumer expenditure, and is _____ related to the level of taxes.
- A) negatively; negatively
 - B) negatively; positively
 - C) positively; negatively
 - D) positively; positively

Answer: C

Ques Status: Previous Edition

- 90) Aggregate output is increased by a decrease in
- A) autonomous consumption.
 - B) government spending.
 - C) planned investment.
 - D) net taxes.

Answer: D

Ques Status: Revised

- 91) Equilibrium output is reduced by an increase in
- A) planned investment.
 - B) taxes.
 - C) government spending.
 - D) net exports.

Answer: B

Ques Status: Revised

- 92) Keynes believed that unstable investment caused the Great Depression. Using the simple Keynesian model, explain how a fall in investment affects equilibrium output.

Answer: A fall in investment will reduce aggregate output by a greater amount than the initial fall in investment. This happens because of the multiplier effect.

Ques Status: Revised

- 93) Show algebraically that the balanced-budget multiplier (that is, a matching change in both government expenditure and net taxes) is equal to one.

Answer: The multiplier for a change in government expenditure equals $\frac{1}{1 - mpc}$ while the

multiplier for net taxes equals $\frac{- mpc}{1 - mpc}$. If government expenditure and taxes are changed in the same direction by the same amount, then the combined (balanced budget) multiplier is:

$$\frac{1}{1 - mpc} + \frac{- mpc}{1 - mpc} = \frac{1 - mpc}{1 - mpc} = 1.$$

Ques Status: New

20.2 The ISLM Model

- 1) If the interest rate falls, other things being equal, investment spending will
- A) fall.
 - B) rise.
 - C) either rise, fall, or remain unchanged.
 - D) not be affected.

Answer: B

Ques Status: Revised

- 2) When the interest rate rises,
- A) planned investment falls.
 - B) planned investment rises.
 - C) planned investment will be unaffected.
 - D) equilibrium income increases.

Answer: A

Ques Status: Previous Edition

- 3) When the interest rate is _____, _____ investments in physical capital will earn more than the cost of borrowed funds, so planned investment spending is _____.
- A) high; few; high
 - B) high; few; low
 - C) low; few; high
 - D) low; many; low
 - E) high; many; high

Answer: B

Ques Status: Previous Edition

4) When interest rates rise in the United States (with the price level fixed), the value of the dollar _____, domestic goods become _____ expensive, and net exports _____.

- A) falls; less; fall
- B) falls; more; rise
- C) rises; more; fall
- D) rises; less; fall

Answer: C

Ques Status: Previous Edition

5) When interest rates fall in the United States (with the price level fixed), the value of the dollar _____, domestic goods become _____ expensive, and net exports _____.

- A) falls; less; fall
- B) falls; less; rise
- C) falls; more; fall
- D) rises; less; fall

Answer: B

Ques Status: Previous Edition

6) An increase in interest rates

- A) increases the value of the dollar, net exports, and equilibrium output.
- B) increases the value of the dollar, reducing net exports and equilibrium output.
- C) reduces the value of the dollar, net exports, and equilibrium output.
- D) reduces the value of the dollar, increasing net exports and equilibrium output.

Answer: B

Ques Status: Revised

7) A decrease in interest rates

- A) increases the value of the dollar, net exports, and equilibrium output.
- B) increases the value of the dollar, reducing net exports and equilibrium output.
- C) reduces the value of the dollar, net exports, and equilibrium output.
- D) reduces the value of the dollar, increasing net exports and equilibrium output.

Answer: D

Ques Status: Revised

8) The negative relation between investment spending and the interest rate is what gives the _____ curve its _____ slope.

- A) IS; upward
- B) IS; downward
- C) LM; downward
- D) LM; upward

Answer: B

Ques Status: Previous Edition

9) Points on the IS curve satisfy

- A) money market equilibrium.
- B) goods market equilibrium.
- C) stock market equilibrium.
- D) bond market equilibrium.

Answer: B

Ques Status: Revised

10) The _____ traces out the points for which total quantity of goods produced equals total quantity of goods demanded.

- A) LM curve
- B) IS curve
- C) consumption function
- D) investment schedule

Answer: B

Ques Status: Previous Edition

11) The _____ describes points for which the goods market is in equilibrium.

- A) LM curve
- B) IS curve
- C) consumption function
- D) investment schedule

Answer: B

Ques Status: Previous Edition

- 12) Everything else held constant, if aggregate output is to the right of the IS curve, then there is an excess _____ of goods which will cause aggregate output to _____.
- A) supply; fall
 - B) supply; rise
 - C) demand; fall
 - D) demand; rise

Answer: A

Ques Status: New

- 13) Everything else held constant, if aggregate output is to the left of the IS curve, then there is an excess _____ of goods which will cause aggregate output to _____.
- A) supply; fall
 - B) supply; rise
 - C) demand; fall
 - D) demand; rise

Answer: D

Ques Status: New

- 14) Everything else held constant, if aggregate output is to the _____ of the IS curve, then there is an excess supply of goods which will cause aggregate output to _____.
- A) right; fall
 - B) right; rise
 - C) left; fall
 - D) left; rise

Answer: A

Ques Status: New

- 15) Everything else held constant, if aggregate output is to the _____ of the IS curve, then there is an excess demand of goods which will cause aggregate output to _____.
- A) right; fall
 - B) right; rise
 - C) left; fall
 - D) left; rise

Answer: D

Ques Status: New

- 16) Everything else held constant, if aggregate output is to the _____ of the IS curve, then there is an excess _____ of goods which will cause aggregate output to fall.
- A) right; supply
 - B) right; demand
 - C) left; supply
 - D) left; demand

Answer: A

Ques Status: New

- 17) Everything else held constant, if aggregate output is to the _____ of the IS curve, then there is an excess _____ of goods which will cause aggregate output to rise.
- A) right; supply
 - B) right; demand
 - C) left; supply
 - D) left; demand

Answer: D

Ques Status: New

- 18) The money market is in equilibrium
- A) at any point on the IS curve.
 - B) at any point on the LM curve.
 - C) at only one point on the LM curve.
 - D) only at the intersection of the IS and LM curves.

Answer: B

Ques Status: Revised

- 19) The _____ describes the combinations of interest rates and aggregate output for which the quantity of money demanded equals the quantity of money supplied.
- A) IS curve
 - B) LM curve
 - C) consumption function
 - D) investment schedule

Answer: B

Ques Status: Previous Edition

20) In the Keynesian model the quantity of money demanded is _____ related to income and _____ related to the interest rate.

- A) positively; positively
- B) positively; negatively
- C) negatively; negatively
- D) negatively; positively

Answer: B

Ques Status: Revised

21) According to the liquidity preference theory, the demand for money is _____ related to aggregate output and _____ related to interest rates.

- A) negatively; negatively
- B) negatively; positively
- C) positively; negatively
- D) positively; positively

Answer: C

Ques Status: Previous Edition

22) As interest rates rise, the opportunity cost of holding money _____ and the demand for money _____.

- A) rises; rises
- B) rises; falls
- C) falls; rises
- D) falls; falls

Answer: B

Ques Status: Previous Edition

23) As aggregate output rises, the demand for money _____ and the interest rate _____, so that money demanded equals money supplied and the money market is in equilibrium.

- A) increases; rises
- B) increases; falls
- C) decreases; rises
- D) decreases; falls

Answer: A

Ques Status: Previous Edition

- 24) Everything else held constant, if aggregate output is to the right of the LM curve, then there is an excess _____ of money which will cause the interest rate to _____.
- A) supply; fall
 - B) supply; rise
 - C) demand; fall
 - D) demand; rise

Answer: D

Ques Status: New

- 25) Everything else held constant, if aggregate output is to the left of the LM curve, then there is an excess _____ of money which will cause the interest rate to _____.
- A) supply; fall
 - B) supply; rise
 - C) demand; fall
 - D) demand; rise

Answer: A

Ques Status: New

- 26) Everything else held constant, if aggregate output is to the _____ of the LM curve, then there is an excess supply of money which will cause the interest rate to _____.
- A) right; fall
 - B) right; rise
 - C) left; fall
 - D) left; rise

Answer: C

Ques Status: New

- 27) Everything else held constant, if aggregate output is to the _____ of the LM curve, then there is an excess demand of money which will cause the interest rate to _____.
- A) right; fall
 - B) right; rise
 - C) left; fall
 - D) left; rise

Answer: B

Ques Status: New

- 28) Everything else held constant, if aggregate output is to the _____ of the LM curve, then there is an excess _____ of money which will cause the interest rate to fall.
- A) right; supply
 - B) right; demand
 - C) left; supply
 - D) left; demand

Answer: C

Ques Status: New

- 29) Everything else held constant, if aggregate output is to the _____ of the LM curve, then there is an excess _____ of money which will cause the interest rate to rise.
- A) right; supply
 - B) right; demand
 - C) left; supply
 - D) left; demand

Answer: B

Ques Status: New

- 30) The Federal Reserve increases interest rates when it wants to reduce aggregate demand to fight inflation. How do increases in the interest rate reduce aggregate demand?

Answer: Increases in interest rates reduce planned investment. The decrease in investment reduces equilibrium output by a multiple amount due to the multiplier effect. Also, increases in interest rates increase the value of the dollar, reducing net exports, which reduce aggregate demand and equilibrium output by a multiple amount.

Ques Status: Previous Edition

20.3 ISLM Approach to Aggregate Output and Interest Rates

- 1) Macroeconomic equilibrium requires
- A) equilibrium in the goods market.
 - B) equilibrium in the money market.
 - C) equilibrium in both the goods and money markets.
 - D) equilibrium in neither the goods nor the money market.

Answer: C

Ques Status: Previous Edition

- 2) When the IS and LM curves are combined in the same diagram, the intersection of the two curves determines the equilibrium level of _____ as well as the _____.
- A) aggregate output; price level
 - B) aggregate output; interest rate
 - C) money supply; price level
 - D) consumer expenditures; interest rate

Answer: B

Ques Status: Previous Edition

- 3) If the economy is on the LM curve, but is to the right of the IS curve, aggregate output will _____ and the interest rate will _____.
- A) rise; rise
 - B) rise; fall
 - C) fall; rise
 - D) fall; fall

Answer: D

Ques Status: Previous Edition

- 4) If the economy is on the LM curve, but is to the left of the IS curve, aggregate output will _____ and the interest rate will _____.
- A) rise; rise
 - B) rise; fall
 - C) fall; rise
 - D) fall; fall

Answer: A

Ques Status: Previous Edition

- 5) If the economy is on the IS curve, but is to the left of the LM curve, aggregate output will _____ and the interest rate will _____.
- A) rise; rise
 - B) rise; fall
 - C) fall; rise
 - D) fall; fall

Answer: B

Ques Status: Previous Edition

- 6) If the economy is on the IS curve, but is to the right of the LM curve, aggregate output will _____ and the interest rate will _____.
- A) rise; rise
 - B) rise; fall
 - C) fall; rise
 - D) fall; fall

Answer: C

Ques Status: Previous Edition

- 7) If the economy is on the IS curve, but is to the left of the LM curve, then the _____ market is in equilibrium, but the interest rate is _____ the equilibrium level.
- A) goods; below
 - B) goods; above
 - C) money; below
 - D) money; above

Answer: B

Ques Status: Previous Edition

- 8) If the economy is on the LM curve, but is to the right of the IS curve, then the _____ market is in equilibrium, but aggregate _____ exceeds aggregate _____.
- A) goods; output; demand
 - B) goods; demand; output
 - C) money; output; demand
 - D) money; demand; output

Answer: C

Ques Status: Previous Edition