Name: __________________________ Date: _04.08.2004_______

(write your name in capitals)

This closed book quiz is an individual work, any discussion with classmate(s) is considered as cheating. If you have any questions ask TA.

1. According to the *IS-LM* model, if Congress raises taxes but the Fed wants to hold the interest rate constant, then the Fed must ______ the money supply.

A) increase
B) decrease
C) first increase and then decrease
D) first decrease and then increase

2. If the demand for real money balances does *not* depend on the interest rate, then the *LM* curve:

A) slopes up to the right.
B) slopes down to the right.
C) is horizontal.
D) is vertical.

3. If investment does not depend on the interest rate, then the ______ curve is ______.

A) *IS*; vertical
B) *IS*; horizontal
C) *LM*; vertical
D) *LM*; horizontal

4. If money demand does not depend on the interest rate, then the *LM* curve is ______ and ______ policy has no effect on output.

A) horizontal; fiscal
B) vertical; fiscal
C) horizontal; monetary
D) vertical; monetary

5. The introduction of a stylish new line of Toyotas, which makes some consumers prefer foreign cars over domestic cars, will, according to the Mundell-Fleming model with floating exchange rates, lead to:

A) a fall in income and net exports.
B) no change in income or net exports.
C) a fall in income but no change in net exports.
D) no change in income but a fall in net exports.

6. In the Mundell-Fleming model with a fixed exchange rate, a rise in the world interest rate will lead income:

A) and net exports both to fall.

B) to fall while net exports are unchanged.
C) to be unchanged and net exports to fall.
D) and net exports to both be unchanged.

7. In the Mundell-Fleming model with a floating exchange rate, a rise in the world interest rate will lead income:
A) and net exports both to fall.
B) to rise and net exports to fall.
C) to fall and net exports to rise.
D) and net exports both to rise.

8. In a small open economy with a floating exchange rate, if the government adopts an expansionary fiscal policy, in the new short-run equilibrium:
A) income and the exchange rate will both rise.
B) the exchange rate will rise, but income will remain unchanged.
C) income will rise, but the exchange rate will remain unchanged.
D) both income and the interest rate will rise.

9. To maintain a fixed-exchange-rate system, if the exchange rate moves below the fixed-exchange-rate level, then the central bank must:
A) buy foreign currency.
B) sell foreign currency from reserves.
C) raise taxes.
D) decrease government spending.

10. According to the Mundell-Fleming model, in an economy with flexible exchange rates, expansionary fiscal policy causes net exports to ______ and expansionary monetary policy causes net exports to ______.
A) increase; increase
B) increase; decrease
C) decrease; decrease
D) decrease; increase

11. In a small open economy with a floating exchange rate, if the government imposes a tariff on foreign goods, then in the new short-run equilibrium:
A) imports will decrease while exports remain constant, leading to a rise in net exports.
B) imports will decrease and exports will increase, leading to a rise in net exports.
C) imports will decrease and exports will decrease by an equal amount.
D) both imports and exports will remain unchanged.

12. In the Mundell-Fleming model:
A) the exchange rate system must have a floating exchange rate.
B) the exchange rate system must have a fixed exchange rate.
C) it makes no difference whether the exchange rate system has a floating or a fixed

exchange rate.
D) the behavior of the economy depends on whether the exchange rate system has a floating or fixed exchange rate.

13. If short-run equilibrium in the Mundell-Fleming model is represented by a graph with *Y* along the horizontal axis and the exchange rate along the vertical axis, then the IS^* curve:
A) slopes downward and to the right because the higher the exchange rate, the lower the level of net exports and, therefore, of short-run equilibrium income in the goods market.
B) is vertical because there is only one investment level that is consistent with the world interest rate.
C) is vertical because the exchange rate does not enter into the IS^* equation.
D) slopes downward and to the right because the higher the exchange rate, the higher the level of net exports and, therefore, of short-run equilibrium income in the goods market.

14. One argument favoring a fixed-exchange-rate system is that it:
A) allows monetary policy to be used for stabilizing output and prices.
B) reduces exchange-rate uncertainty, thereby promoting more international trade.
C) leads to excessive growth of the money supply.
D) requires no actions on the part of the central bank to implement.

15. In the *IS-LM* model under the usual conditions in a closed economy, an increase in government spending increases the interest rate and crowds out:
A) prices.
B) investment.
C) the money supply.
D) taxes.

16. An economic change that does *not* shift the aggregate demand curve is a change in:
A) the money supply.
B) the investment function.
C) the price level.
D) taxes.

17. Investment depends on the ______ interest rate, and money demand depends on the ______ interest rate.
A) real; real
B) nominal; nominal
C) real; nominal
D) nominal; real

18. In the *IS-LM* model when government spending rises, in short-run equilibrium, in

the usual case, the interest rate ______ and output ______.

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

19. In the *IS-LM* model when *M* remains constant but *P* rises, in short-run equilibrium, in the usual case, the interest rate ______ and output ______.

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

20. In the *IS-LM* model, a decrease in the interest rate would be the result of a(n):

A) increase in the money supply.
B) increase in government purchases.
C) decrease in taxes.
D) increase in money demand.