QUIZ ON IS-LM MODEL OF BUSINESS CYCLES

Pascal Michaillat

Question 1

Disposable income equals:

A) Income minus saving

B) Income minus both saving and taxes

C) Consumption minus taxes

D) Income plus government transfers plus taxes

E) Income plus government transfers minus taxes

Question 2

If the marginal propensity to consume increases, then:

A) The level of consumption that occurs if disposable income is zero goes up.

B) People increase consumption less after an increase in income.

C) People increase saving more after an increase in income.

D) People reduce consumption more after an increase in taxes.

E) People reduce consumption less after an increase in taxes.

Question 3

Suppose that the consumption function is $C = 250 + 0.75 \times D$, that investment is $I=75$, that government spending is $G=100$, and that taxes (net of transfers) are $T=100$. Then the expenditure function is:

A) $Z(Y) = 250 + 0.75 \times Y$

B) $Z(Y) = 250 + 0.25 \times Y$

C) $Z(Y) = 350 + 0.25 \times Y$

D) $Z(Y) = 350 + 0.75 \times Y$

E) $Z(Y) = 525 + 0.75 \times Y$

Question 4

Suppose that the consumption equation is represented by $C = 100 + 0.5 \times D$, investment is $I=100$, government spending is $G=150$, and taxes (net of transfers) are $T=100$. Then the spending multiplier is:

A) 0.5

B) 0.75

C) 4

D) 0.25

E) 2

Question 5

Suppose that the consumption equation is represented by $C = 100 + 0.5 \times D$, investment is $I = 100$, government spending is $G = 150$, and taxes (net of transfers) are $T = 100$. Then autonomous expenditure is:

A) 100

B) 350

C) 300

D) 450

E) 400

Question 6

With a usual consumption function, which of the following occurs when disposable income is zero?

A) Consumption must be zero.

B) Saving must be zero.

C) Saving must be positive.

D) Consumption must be negative.

E) Saving must be negative.

Question 7

Suppose a government bond offers to pay $200 in one year from now and currently sells for $150. Given this information, we know that the interest rate on the bond is:

A) 5.3%

B) 25%

C) 33%

D) 50%

E) 200%

Question 8

Which of the following raises the amount of money that one wishes to hold?

A) An increase in the interest rate

B) A reduction in the interest rate

C) A reduction in income

D) A reduction in the price of bonds

E) An increase in the money supply

Question 9

The money demand curve will shift to the left when which of the following occurs?

A) An increase in income

B) An increase in the interest rate

C) A reduction in the money supply

D) A reduction in income

E) A reduction in the interest rate

Question 10

What is central-bank money composed of?

A) Only bank reserves

B) Currency in circulation plus bank reserves

C) Currency in circulation plus checkable deposits

D) Only checkable deposits

E) Currency in circulation, bank reserves, and checkable deposits

Question 11

An open market purchase of bonds by the central bank will cause which of the following when the economy is at the zero lower bound (ZLB)?

A) The price of bonds will increase.

B) The price of bonds will not change.

C) The price of bonds will decrease.

D) The money supply, M, will not change.

E) The supply of central-bank money, H, will not change.

Question 12

Which of the following generally occurs when a central bank pursues expansionary monetary policy?

A) The central bank purchases bonds and the interest rate increases.

B) The central bank purchases bonds and the interest rate decreases.

C) The central bank sells bonds and the interest rate increases.

D) The central bank sells bonds and the interest rate decreases.

Question 13

In late 2007 and early 2008, the US Federal Reserve pursued expansionary monetary policy. Which of the following occurred as a result of this monetary policy action?

A) The LM curve shifted down.

B) The LM curve shifted up.

C) The IS curve shifted rightward.

D) The IS curve shifted leftward.

Question 14

Consider an IS-LM model in which investment spending depends positively on output but no longer depends on the interest rate. What will happen after an expansionary monetary policy?

A) Investment and output will decrease.

B) Investment and output will increase.

C) There will be no effect on output or investment.

D) Investment will remain the same but output will increase.

E) Output will remain the same but investment will increase.

Question 15

Suppose the consumption function is C = 250 + 0.75 × D and the investment function is I = 200 – 200 × i. Assume government spending increases by 100. What will happen to the IS curve?

A) It will shift rightward by 200.

B) It will shift rightward by 750.

C) It will shift rightward by 400.

D) It will remain the same.

E) It will shift leftward by 400.

Question 16

Assume that consumption depends positively on disposable income and that investment depends positively on income and negatively on the interest rate. Then imagine that everybody wants to save more (c_0 decreases in the consumption function). What happens to private saving in the IS-LM model?

A) Private saving increases but investment falls.

B) Private saving stays the same but output falls.

C) Private saving increases but investment stays the same.

D) Private saving increases but output falls.

E) Private saving and output decrease.

Question 17

During 2008 in the United States, consumer confidence fell significantly. Which of the following occurred as a result of this reduction in consumer confidence?

A) The LM curve shifted up.

B) The LM curve shifted down.

C) The IS curve shifted rightward.

D) The IS curve shifted leftward.

E) The IS curve shifted rightward, and the LM curve shifted up.

Question 18

In the IS-LM model, an equal and simultaneous reduction in government spending G and taxes net of transfers T causes:

A) An increase in output

B) No change in output

C) A reduction in output

D) An increase in interest rate

E) A reduction in government deficit

Question 19

Suppose fiscal policy makers implement a policy to reduce the size of the budget deficit. Based on the IS-LM model, we know that the following will occur with certainty as a result of this policy:

A) Output will decrease.

B) Output will increase.

C) Government spending will increase.

D) Government spending will decrease.

E) We cannot tell for sure.

Question 20

Suppose policy makers decide to increase taxes. This policy action causes which of the following to occur?

A) The LM curve shifts down and the economy moves along the IS curve.

B) The IS curve shifts leftward and the economy moves along the LM curve.

C) Both the IS and LM curves shift.

D) Neither the IS nor the LM curve shifts.

E) The IS curve shifts rightward and the economy moves along the LM curve.

Question 21

Suppose there is a simultaneous fiscal expansion and monetary expansion. Based on the IS-LM model, we know that:

A) Output will increase.

B) Output will decrease.

C) The interest rate will increase.

D) Investment will decrease.

E) Output will remain the same.