

1. If money demand does not depend on income, then the _____ curve is _____.
- A) IS; vertical B) IS; horizontal C) LM; vertical D) LM; horizontal
2. If consumption is given by $C = 200 + 0.75(Y - T)$ and investment is given by $I = 200 - 25r$, then the formula for the IS curve is:
- A) $Y = 400 - 0.75T - 25r + G$. B) $Y = 1,600 - 3T - 100r + 4G$.
 C) $Y = 400 + 0.75T - 25r - G$. D) $Y = 1,600 + 3T - 100r - 4G$.
3. Those economists who believe that monetary policy is more potent than fiscal policy argue that the:
- A) responsiveness of money demand to the interest rate is large.
 B) responsiveness of money demand to the interest rate is small.
 C) IS curve is nearly vertical.
 D) LM curve is nearly horizontal.
4. If the investment demand function is $I = c - dr$ and the quantity of real money demanded is $eY - fr$, then fiscal policy is relatively potent in influencing aggregate demand when d is _____ and f is _____.
- A) large; small B) small; small C) small; large D) large; large
5. Other things equal, a given change in government spending has a larger effect on demand the:
- A) flatter the LM curve. B) steeper the LM curve.
 C) smaller the interest sensitivity of money demand.
 D) larger the income sensitivity of money demand.

12. A movement along an aggregate demand curve corresponds to a change in income in the IS-LM model _____, while a shift in an aggregate demand curve corresponds to a change in income in the IS-LM model _____.

- A) resulting from a change in monetary policy; resulting from a change in fiscal policy
- B) resulting from a change in fiscal policy; resulting from a change in monetary policy
- C) at a given price level; resulting from a change in the price level
- D) resulting from a change in the price level; at a given price level

13. If real money balances enter the IS-LM model both through the theory of liquidity preference and the Pigou effect, than a fall in the price level will shift:

- A) only the LM curve.
- B) only the IS curve.
- C) both the LM and the IS curves.
- D) neither the LM nor the IS curves.

14. When bond traders for the Federal Reserve seek to increase interest rates, they _____ bonds, which shifts the _____ curve to the left.

- A) buy; IS
- B) buy; LM
- C) sell; IS
- D) sell; LM

1. Compared to a closed economy, an open economy is one that:

- A) allows the exchange rate to float.
- B) fixes the exchange rate.
- C) trades with other countries.
- D) does not trade with other countries.

2. In the Mundell-Fleming model, the domestic interest rate is determined by the:

- A) intersection of the LM and IS curves.
- B) domestic rate of inflation.
- C) world rate of inflation.
- D) world interest rate.

3. In a small open economy with perfect capital mobility, if the domestic interest rate were to rise above the world interest rate, then _____ would drive the domestic interest rate back to the level of the world interest rate.

- A) capital inflow
- B) capital outflow
- C) the central bank
- D) a decline in domestic saving

4. In the Mundell-Fleming model on a $Y - e$ graph, the curves labeled IS^* and LM^* are labeled that way as a reminder that:

- A) the price level is held constant at the world price level p^* .
- B) the interest rate is held constant at the world interest rate r^* .
- C) the exchange rate is held constant at the world exchange rate e^* .
- D) output is held constant at the full employment level.

5. Under a floating system, the exchange rate:

- A) fluctuates in response to changing economic conditions.
- B) is maintained at a predetermined level by the central bank.
- C) is changed at regular intervals by the central bank.
- D) fluctuates in response to changes in the price of gold.

6. In a small open economy with a floating exchange rate, the exchange rate will depreciate if:

- A) the money supply is increased.
- B) import quotas are imposed.
- C) government spending is increased.
- D) the money supply is decreased.

7. In a small open economy with a floating exchange rate, if the government decreases the money supply, then in the new short-run equilibrium:

- A) income falls and the exchange rate rises.
- B) the exchange rate falls and income rises.
- C) income remains unchanged but the exchange rate rises.
- D) the exchange rate remains unchanged but income falls.

8. 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.

9. Under a fixed-exchange-rate system, the central bank of a small open economy must:

- A) have a reserve of its own currency, which it must have accumulated in past transactions.
- B) have a reserve of foreign currency, which it can print.
- C) allow the money supply to adjust to whatever level will ensure that the equilibrium exchange rate equals the announced exchange rate.
- D) follow a rule specifying a constant growth rate for the money supply.

10. In the Mundell-Fleming model with fixed exchange rates, attempts by the central bank to decrease the money supply:

- A) lead to a lower equilibrium level of income.
- B) lead to a higher equilibrium level of income.
- C) must be abandoned in order to maintain the fixed exchange rate.
- D) must be offset by expansionary fiscal policy.

11. During the Great Depression, countries that devalued their currencies generally _____ whereas countries that maintained the old exchange rate _____.

- A) suffered longer; experienced no depression
- B) recovered relatively quickly; experienced no depression
- C) suffered longer; recovered relatively quickly
- D) recovered relatively quickly; suffered longer

12. In the Mundell-Fleming model, expectations that a currency will lose value in the future will cause the current exchange rate to:

- A) increase in the present.
- B) decrease in the present.
- C) remain constant in the present.
- D) decrease only in the future.

13. According to the Mundell-Fleming model with floating exchange rates, political uncertainty in Mexico in 1994 caused the risk premium on Mexican interest rates to _____ and the Mexican exchange rate to _____.

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

14. One argument favoring a floating-exchange-rate system is that it:

- A) makes international trade less difficult.
- B) minimizes destabilizing speculation by international investors.
- C) allows monetary policy to be used for other purposes.
- D) helps prevent excessive growth in the money supply.

15. A monetary union with a common currency is an example of a:

- A) fixed-exchange-rate system.
- B) flexible-exchange-rate system.
- C) small open economy.
- D) large open economy.

16. An arrangement by which a central bank holds enough foreign currency to back each unit of the domestic currency is called a:

- A) floating exchange rate.
- B) dollarization.
- C) monetization.
- D) currency board.

17. If a country chooses to restrict international capital flows and to maintain a fixed exchange rate, then it must:

- A) live with exchange-rate volatility.
- B) control its citizen's access to world financial markets.
- C) give up the use of monetary policy for purposes of domestic stabilization.
- D) give up the use of fiscal policy for purposes of domestic stabilization.

18. In the Mundell-Fleming model, if the economy is operating at or below the natural level in the short run, then in the long run the price level will fall, the exchange rate will _____, and net exports will _____ to restore the economy to its natural rate.

- A) appreciate; increase
- B) appreciate; decrease
- C) depreciate; increase
- D) depreciate; decrease