I. Multiple Choice

1. Assume that the Cambridge k equals 0.2. If income is equal to $100,000, the transactions demand for money is equal to ___.
   - A. $100,000
   - B. $500,000
   - C. $120,000
   - D. $20,000

2. For an individual LM curve, the money supply is assumed to ___.
   - A. grow at a rate equal to the interest rate
   - B. be constant
   - C. grow at a rate equal to the growth rate in income
   - D. grow at a rate equal to the marginal propensity to consume

3. Which of the following will cause the LM curve to shift to the left?
   - A. a decrease in the money supply
   - B. a decrease in investment
   - C. a decrease in money demand
   - D. an increase in velocity

4. Which of the following is an equilibrium condition for the goods market?
   - A. money demand = money supply
   - B. MV = PT
   - C. desired expenditure = total production
   - D. IS = LM

5. The less the marginal propensity to consume, the ___.
   - A. steeper the IS curve will be
   - B. flatter the IS curve will be
   - C. steeper the LM curve will be
   - D. flatter the IS curve will be

6. Suppose k = 0.25. With a $100 billion increase in the money supply, the LM curve shifts ___.
   - A. to the right by $400 billion
   - B. to the left by $75 billion
   - C. to the right by $25 billion
   - D. to the left by $125 billion
7. Suppose the marginal propensity to consume is 0.75. A $50 billion decrease in
government spending shifts the IS curve __.
A. to the left by $200 billion
B. to the right by $200 billion
C. to the left by $50 billion
D. to the left by $40 billion

8. From an IS-LM equilibrium point, a rise in government spending brings about a new
equilibrium point with ___ income and a ___ interest rate.
A. lower, lower
B. lower, higher
C. higher, higher
D. higher, lower

9. Crowding out is more complete with a _____ LM curve, perhaps due to a lower
_____ sensitivity of money demand.
A. flatter, income
B. flatter, interest rate
C. steeper, interest rate
D. steeper, income

10. With an increase in government expenditure, we ___.
A. move up along the aggregate demand curve
B. shift the aggregate demand curve to the right
C. move down along the aggregate demand curve
D. shift the aggregate demand curve to the left

II. Short Answer
11. A. Explain in words what the LM curve represents.

B. Explain in words what the IS curve represents.
12. What is meant by “crowding out” in the IS-LM world? What makes it more or less of a problem?

13. Is it correct to say that the interest rate is determined by the supply and demand for money, according to the IS-LM analysis? Why or why not?

14. Explain the relationship between the IS and LM curves and the aggregate demand curve.