

NAME :

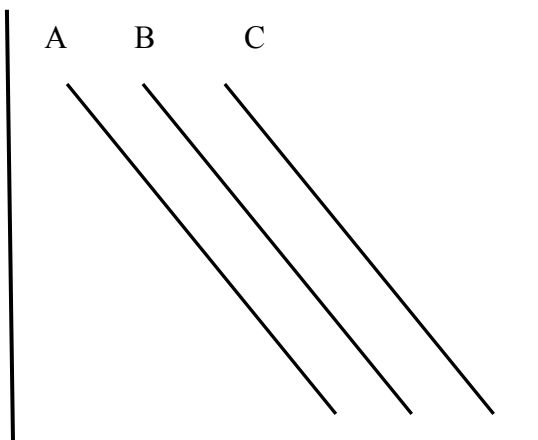
DATE :

1. Figure out the following multiplier questions :

- A. What is the value of the tax increase multiplier if the MPC is .80 ?
- B. Consumption changes by 400 and disposable income by 100 . What is the MPC ?
- C. What is the value of the government spending multiplier if the MPC is .50
- D. If there is a country that has an MPC of .60 in which the government increased spending by \$ 200 and increased taxes by \$ 100 , what would be the change in GDP ?

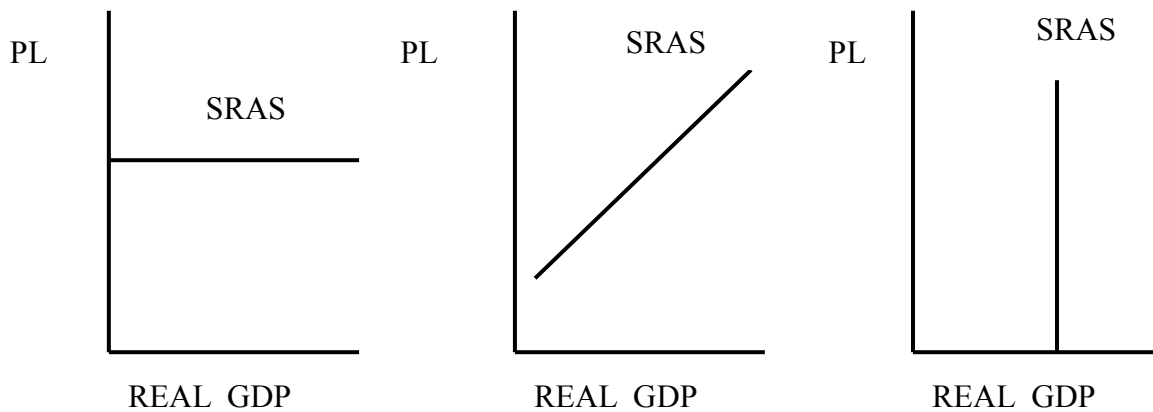
2. Why is the aggregate demand curve downward sloping ?

- A. According to the aggregate demand curve , what is the relationship between the price level and real GDP ?
- B. Explain how each of the following effects helps explain why the AD curve is downward sloping .
 - 1. Interest rate effect :
 - 2. Net export effect :
 - 3. In what ways do the reasons that explain the downward slope of the AD curve differ from the reasons that explain the downward slope of the demand curve for a single product ?
- C. What shifts the aggregate demand curve ? Using the chart below , determine whether each situation will cause an increase (I) , decrease (D) , or no change (NC) in AD . Always start at curve “ B ” . For each situation that causes a change in AD , write the letter of the new demand curve in the “ New AD Curve ” column .



- A. Congress cuts taxes
- B. Business investment spending decreases
- C. Government spending to increase next fiscal year ; president promises not to increase taxes
- D. Survey shows consumer confidence jumps
- E. Stock market collapses ; investors lose billions
- F. Productivity rises for fourth straight year
- G. President cuts defense spending by 20 % ; no increase in domestic spending

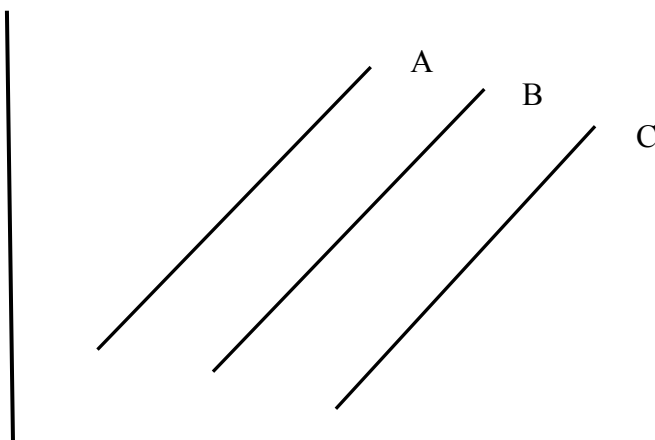
3. Why can the aggregate supply curve have three different shapes ?



- A. Under what conditions would an economy have a horizontal SRAS curve ?
- B. Under what conditions would an economy have a vertical SRAS curve ?
- C. Under what conditions would an economy have a positively sloped SRAS curve ?
- D. Assume AD increased . What would be the effect on real GDP and the price level if the economy had a horizontal SRAS curve ? A positively sloped SRAS curve ? A vertical SRAS curve ?

E. What range of the SRAS curve do you think the economy is in today? Explain your answer.

F. What shifts the SRAS curve? Using the chart below, determine whether each situation will cause an increase (I), decrease (D), or no change (NC) in AD. Always start at curve "B". For each situation that causes a change in SRAS, write the letter of the new demand curve in the "New SRAS Curve" column.



Change In SRAS

New SRAS Curve

A. Unions grow more aggressive; wage rates increase

B. OPEC successfully increases oil prices

C. Labor productivity increases dramatically

D. Giant natural gas discovery decreases energy prices

E. Computer technology brings new efficiency to industries

F. Government spending increases

Change In SRAS

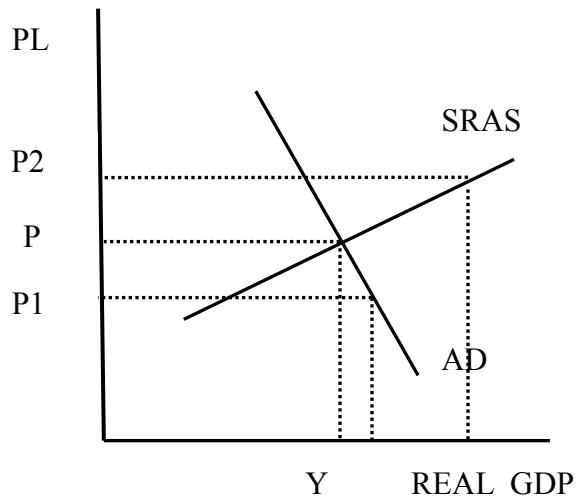
New SRAS Curve

G. Cuts in tax rates increase incentives to save

H. Low birth rate will decrease the labor force in the future

I. Research shows that improved schools have increased the skills of American workers and managers

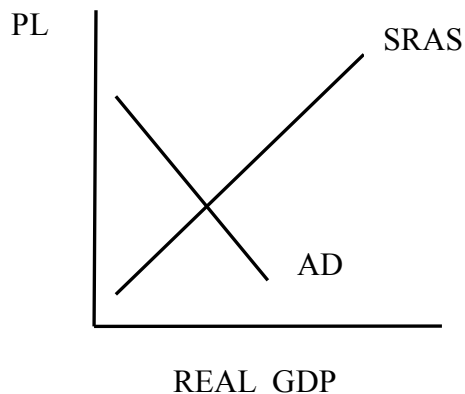
4. *Equilibrium price and output levels based on the chart below :*



- A. *What are the equilibrium price level and output ?*
- B. *What would eventually happen to the price level and output if the initial price level were P2 rather than P ? Why would this happen ?*
- C. *What would eventually happen to the price level and output if the initial price level were P1 rather than P ? Why would this happen ?*

5. *For each situation below , illustrate the change on the aggregate supply and demand graph and describe the effect on the equilibrium price level and real GDP by writing in an (I) for an increase , (D) for a decrease , or (NC) for unchanged .*

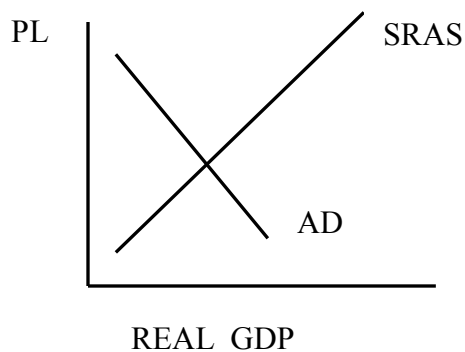
A. *Congress passes a tax cut for the middle class , and the president signs it .*



Price Level :

Real GDP :

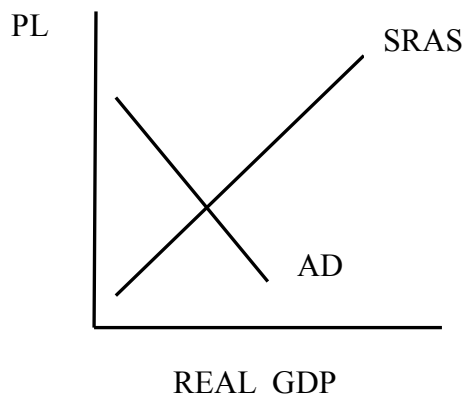
B. *During a recession , the government increases spending on schools , highways , and other public works .*



Price Level :

Real GDP :

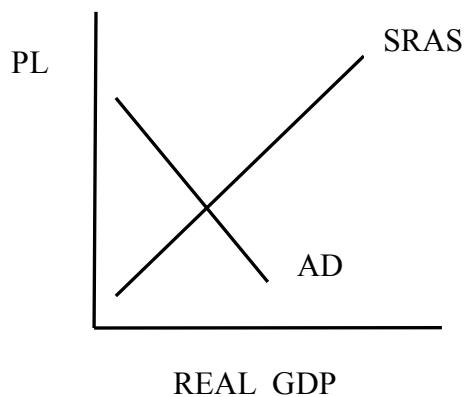
C. *New natural gas discoveries cause large decrease in energy prices .*



Price Level :

Real GDP :

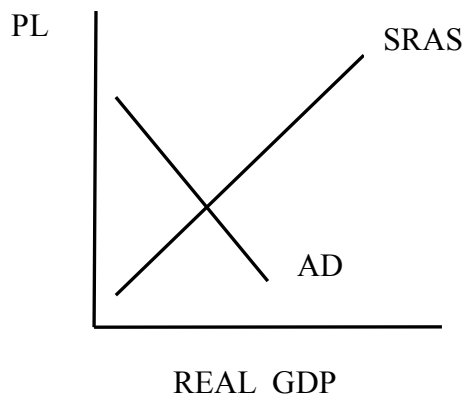
D. *Illustrate the effects of an increase in aggregate demand .*



Price Level :

Real GDP :

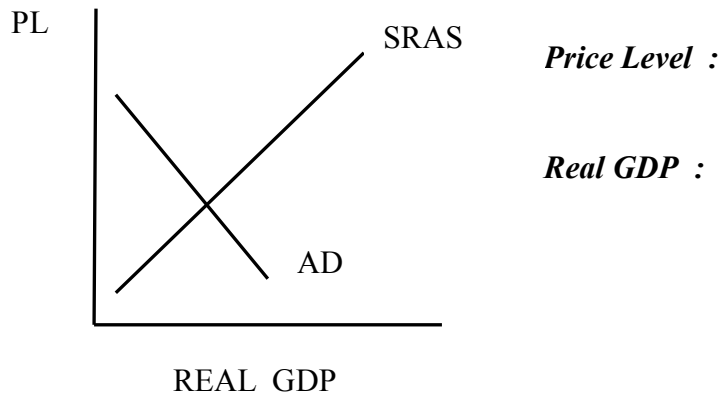
E. *Illustrate the effects of increases in production costs .*



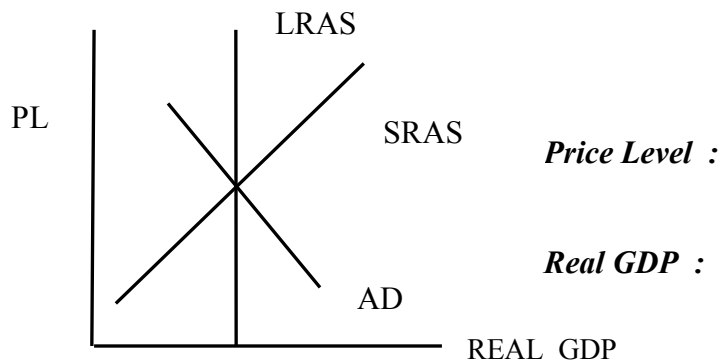
Price Level :

Real GDP :

F. New technology and better education increase productivity .

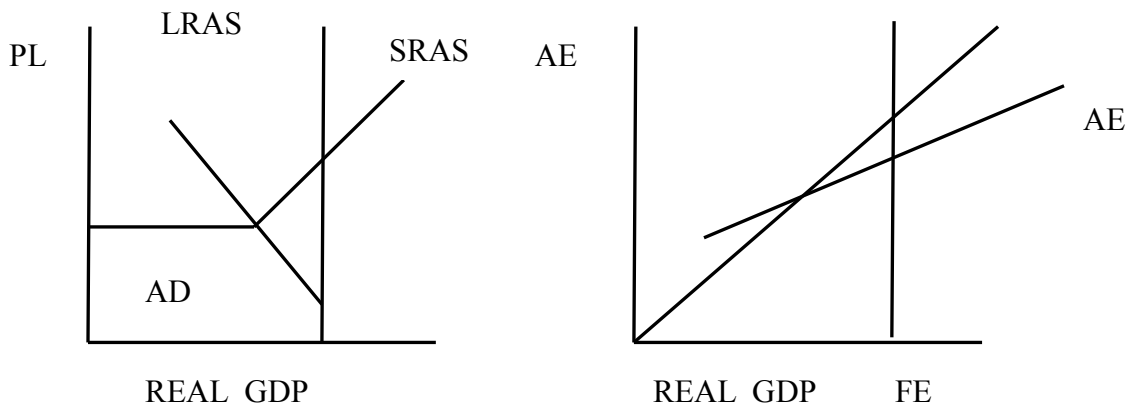


G. With the unemployment rate at 5 % , the federal government reduces personal taxes and increases spending .



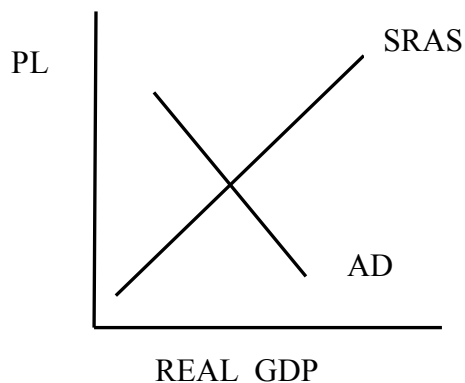
6. Illustrate the indicated change on both the modern AD and AS model , and the Keynesian model .

A. The economy is at less than full employment . Then an increase in consumer confidence moves the economy to full employment .

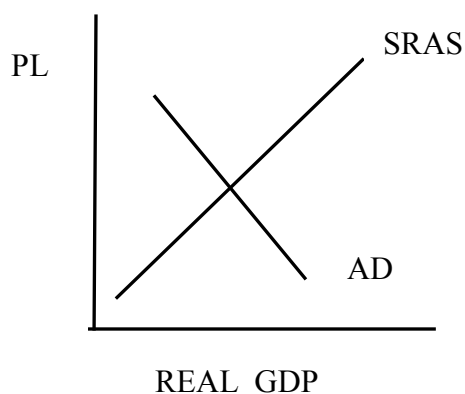


7. An “ exogenous shock ” is a change in a variable outside the primary economic model that affects aggregate demand or supply . For each of the situations below , draw a new curve that will represent the impact of the exogenous demand shock highlighted and briefly explain the reason for the change in the graph .

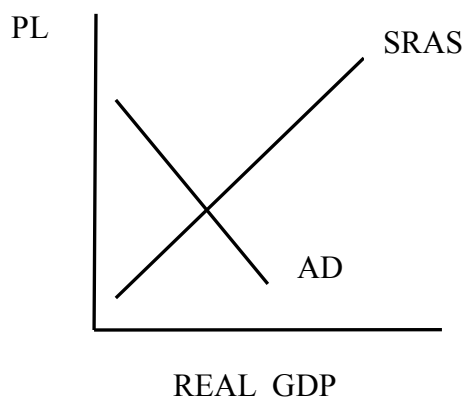
A. As part of its countercyclical policy , the government both reduces taxes and increases transfer payments .



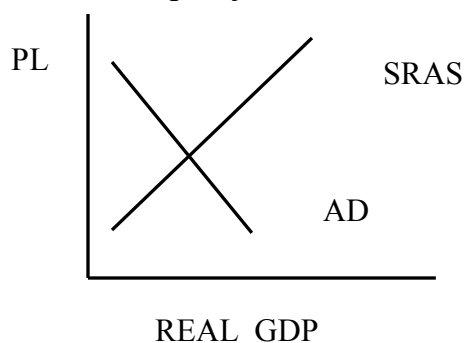
B. While the United States was in the midst of the Great Depression , a foreign power attacked . Congress declared war and more than one million soldiers were drafted in the first year , while defense spending was increased several times over .



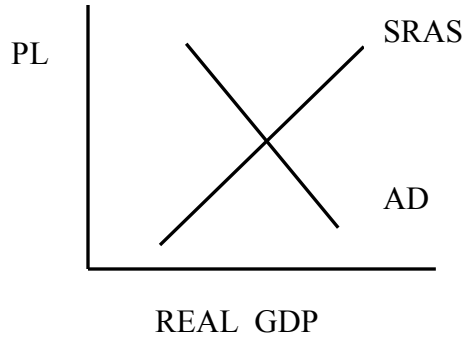
C. Good weather results in the highest corn and wheat yields in 40 years .



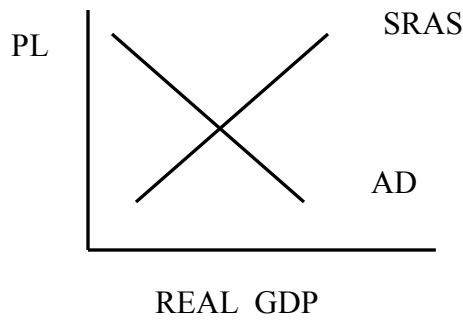
D. An enemy power sets up a blockade of the sea lanes leading to a country , and most ships refuse to deliver cargo through the blockade .



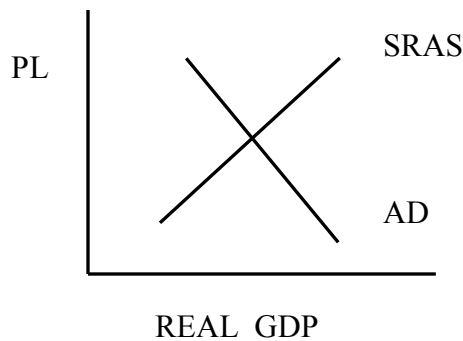
E. To balance the budget, the federal government cuts Social Security payments by 10% and federal aid to education by 20%.



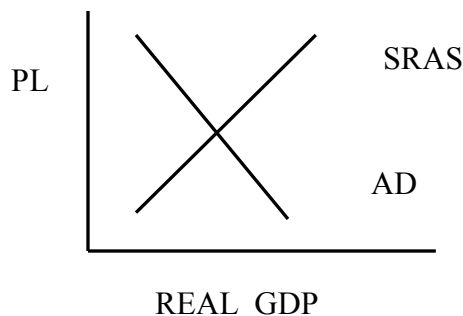
F. During a long, slow recovery from a recession, consumers postponed major purchases. Suddenly they begin to buy cars, refrigerators, and televisions to replace their failing models.



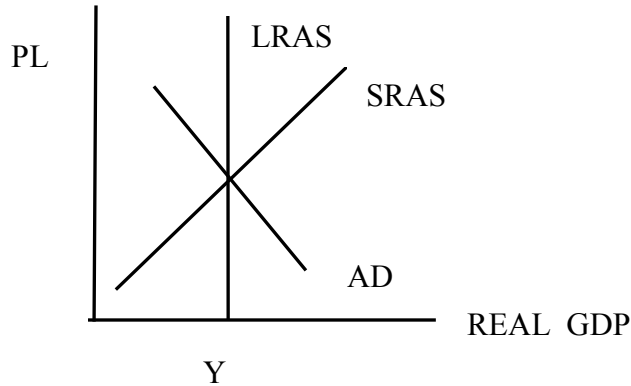
G. With no other dramatic changes, the government raises taxes and reduces transfer payments in the hope of balancing the federal budget.



H. Brazil solves its foreign debt and inflation problems. It then orders ten billion worth of capital equipment from the United States. Illustrate and explain how this affects the United States economy.



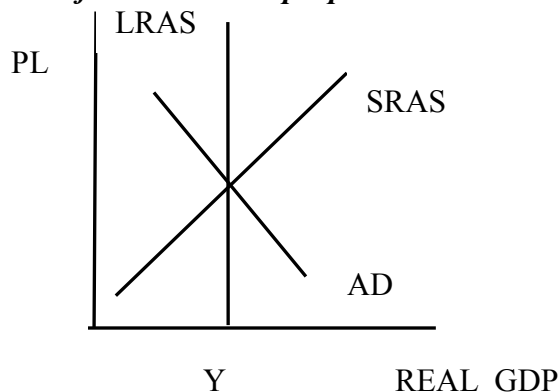
8. *In the following graph , suppose the aggregate demand shifts from AD to AD1 . Being guided by items A through E below , show how the economy will react over time . Assume that no monetary or fiscal policy is undertaken .*



- A. *What will happen to output in the short run ?*
- B. *What will happen to output as the economy moves to the long run equilibrium ? Explain .*
- C. *What will happen to the price level ?*
- D. *What will happen to wages ?*
- E. *In the graph , draw the shifts in AD and SRAS that you think will occur . Indicate the final aggregate demand and short run aggregate supply curves by labeling them as AD1 and SRAS1*

9. *Draw a new SRAS or AD curve that represents the change based on the situation described below . Also , explain the reasons for the change in the graph , and then explain what happens in the long run if no stabilization policy is implemented .*

The government increases spending on education , health care , housing and basic services for low income people . No increase in taxes accompanies the program .



10. Test your understanding of fiscal policy by completing the table below . Your choices for each situation must be consistent , that is , you should choose either an expansionary or contractionary fiscal policy . Be aware that fiscal policy can not provide a solution to one of the situations . Fill in the spaces as follows :

For columns A , B , and C indicate whether you want to increase the item using an I , or decrease it using a D .

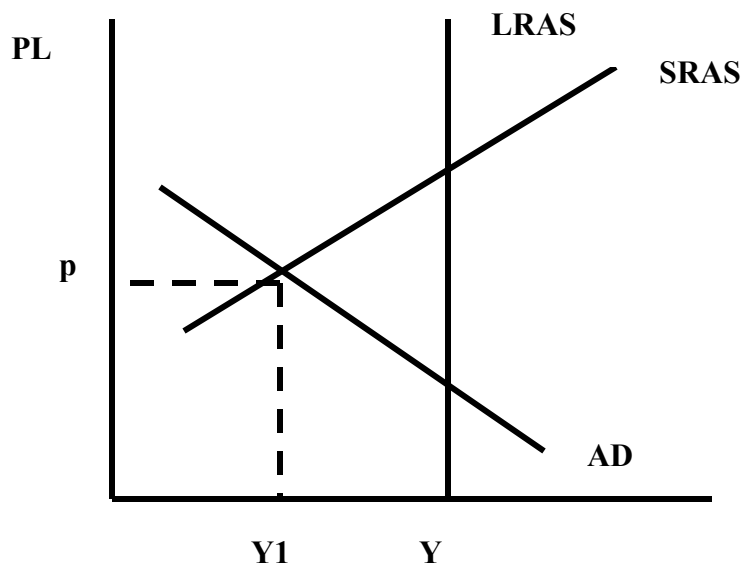
For column D use the I or D to indicate whether the national debt would be increased or decreased .

Situation	(A) – Objective for aggregate demand	(B) – Action on taxes	(C) – Action on government spending	(D) – Effect on the national debt
National unemployment rate rises to 12 %				
Surveys show that consumers are losing confidence in the economy , retail sales are weak , and business inventories are increasing rapidly				
Business sales and investment are expanding rapidly and economists think strong inflation lies ahead				
Inflation persists while unemployment stays high				

11. Label the following scenarios with the type of fiscal policy they are related to . Use an (E) for expansionary and a (C) for contractionary .

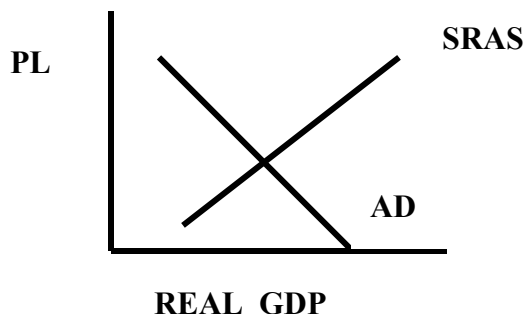
- A. The government cuts personal income taxes
- B. The government increases the capital gains tax
- C. The government launches a major new space program
- D. The government gives all its employees a pay raise

12. Assume a persistent gap between current income , Y_1 , and full employment income , Y , as shown in the figure below .

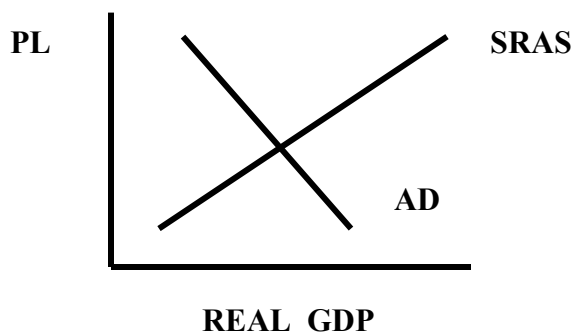


- A. *If the government decided not to implement any fiscal policy, the unemployment of resources would eventually lead to a decrease in factor prices. Show on the graph that this could eliminate the gap.*
- B. *A second possibility would be to depend on a smaller shift of aggregate supply and have a modest shift in aggregate demand by a discretionary fiscal stimulus so that the price level was maintained at “p”. Show these two changes.*
- C. *A third possibility is that government would seek changes in taxes and / or expenditures that would rapidly bring the economy to full employment. Show this on the graph.*
13. *True, false, or uncertain, and explain why? “In the long run, when nominal wages increase, everyone has more money to spend; therefore, the economy as a whole benefits.”*
14. *True, false, or uncertain, and explain why? “Our economy is able to adjust to a long run equilibrium after a decrease in aggregate demand because prices and wages are sticky.”*
15. *True, false, or uncertain and explain why? “If we are in a recession, as long as we continue to increase aggregate demand, we can achieve full employment without driving up the inflation rate.”*
16. *True, false, or uncertain and explain why? “When the economy experiences an increase in aggregate demand, it will discover that its production possibilities curve has shifted outward.”*
17. *Use short run AD and AS analysis to illustrate the results of the following events. Also provide a very brief explanation of the changes.*

- A. *There is a 25% decrease in the price of crude oil*



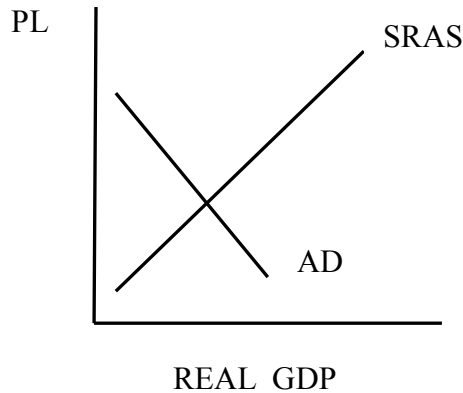
- B. *Price levels in Germany, Japan, and Great Britain rise considerably, while price levels in the United States remain unchanged.*



18. For each situation below, make additions to the graphs to illustrate the change. Then indicate the response in terms of shifts in or movements along the aggregate demand or aggregate supply curve and the short run effect on real GDP and the price level.

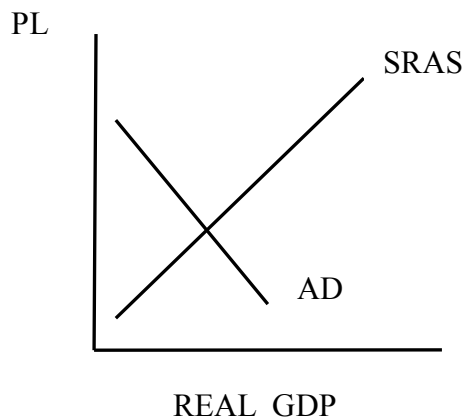
Indicate shifts in the curve by an "S" and movements along the curve by an "A". Indicate the changes in price level, unemployment, and real GDP by writing in an (I) for an increase, (D) for a decrease, or (NC) for unchanged.

- A. Increase in labor productivity due to technological change.



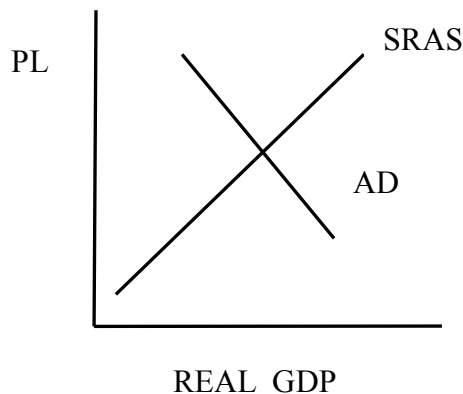
AD Curve :
 AS Curve :
 Real GDP :
 Price Level :
 Unemployment :

- B. Increase in the cost of goods used by many firms.



AD Curve :
 AS Curve :
 Real GDP :
 Price Level :
 Unemployment :

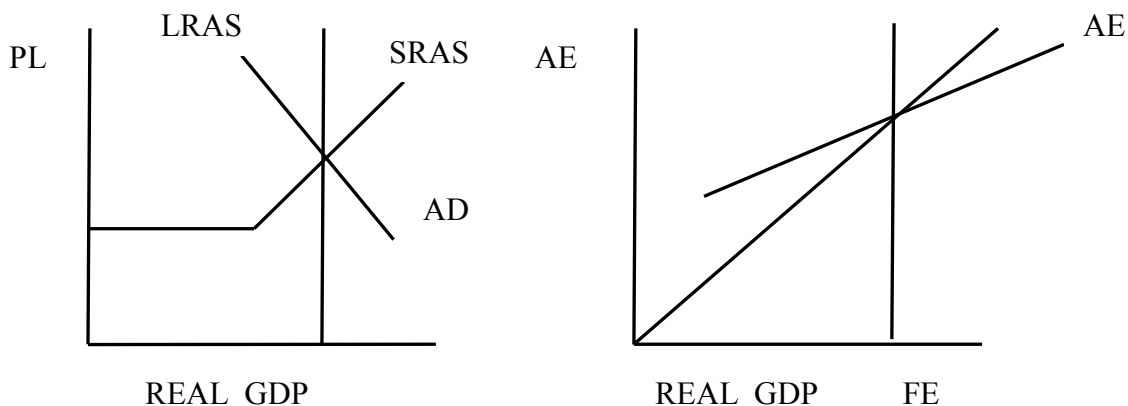
- C. A major reduction in investment and consumer spending.



AD Curve :
 AS Curve :
 Real GDP :
 Price Level :
 Unemployment :

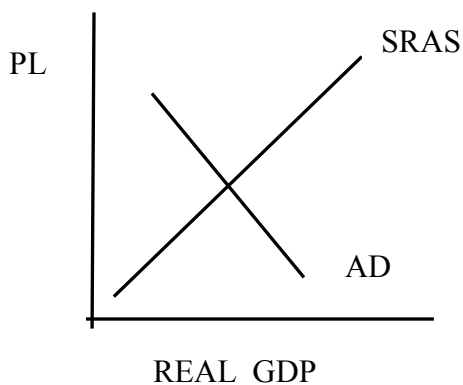
19. *Illustrate the indicated change on both the modern AD and AS model , and the Keynesian model .*

The economy is at full employment but businesses begin to believe that a recession is ahead .

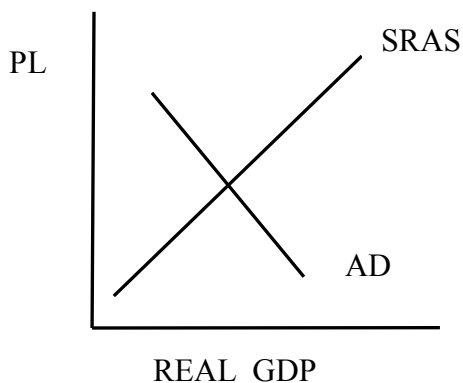


20. *For each of the situations below , draw a new curve that will represent the impact of the exogenous demand shock highlighted and briefly explain the reason for the change in the graph .*

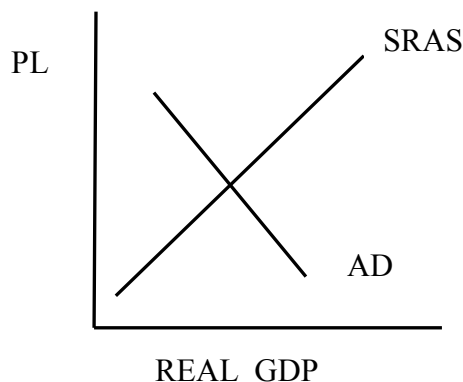
- A. *Economic booms in both Japan and Europe result in massive increases in orders for exported goods from the United States .*



- B. *New environmental standards raise the average cost of autos and truck 5 % .*

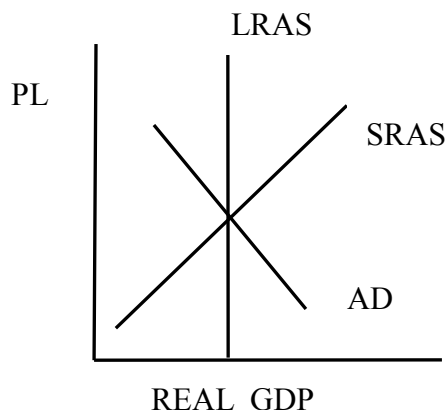


- B.** *To avoid having to pay tariffs , firms begin to build new factories in the United States . In doing so , they invest in advanced United States technology that will help them produce goods in the United States at prices that are competitive .*



- 21.** *Draw a new SRAS or AD curve that represents the change based on the situation described below . Also , explain the reasons for the change in the graph , and then explain what happens in the long run if no stabilization policy is implemented .*

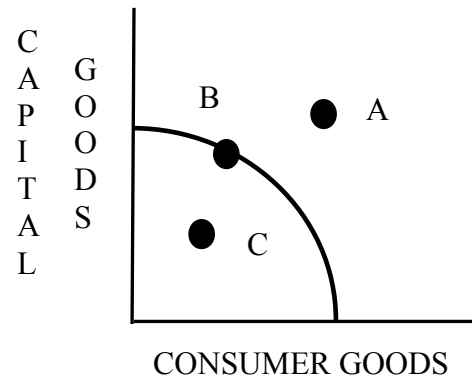
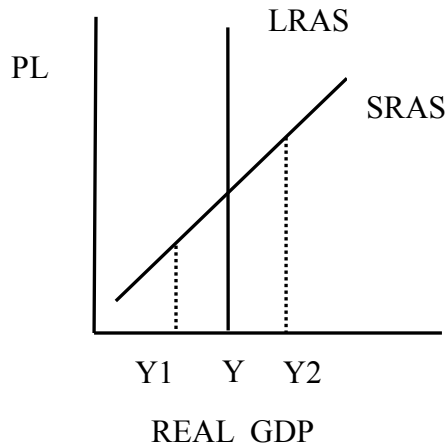
OPEC cuts oil production by 30 % , and the world price for oil rises by 40 % .



- 22.** *Answer the following questions regarding the aggregate supply and production possibilities curves (PPC) .*

- A.** *What information does a PPC provide for us about a nation's economy ?*
- B.** *What would cause a nation's PPC to shift ?*
- C.** *What do you know about a nation's economy that is operating on the LRAS curve ?*
- D.** *If the price level rises , will LRAS curve shift ? Will the LRAS curve shift if AD changes ?*

Base your answers to E through J on the charts below



- E. *If an economy finds that it faces a short run equilibrium where real GDP is Y_1 , how would you describe the condition of the economy? Given this equilibrium level of output, at what point would the economy line on the PPC? Explain your answer.*
- F. *If an economy finds that it faces a short run equilibrium where real GDP is Y , how would you describe the condition of the economy? Given this equilibrium level of output, at what point would the economy line on the PPC? Explain your answer.*
- G. *If an economy finds that it faces a short run equilibrium where real GDP is Y_2 , how would you describe the condition of the economy? Given this equilibrium level of output, at what point would the economy line on the PPC? Explain your answer.*
- H. *If the economy were producing at Y_2 , what would happen in the long run? Why?*
- I. *What would cause a nation's LRAS curve to shift?*
- J. *How would a rightward shift in LRAS be shown on a PPC?*
23. *Assume that a hypothetical economy is currently at an equilibrium national income level of \$ 1 trillion, but the full employment national income is \$ 1.2 trillion. Assume the government's budget is currently in balance at \$ 200 billion and the marginal propensity to consume is 0.75. Use this data to answer the questions below.*
- A. *What is the gap between the equilibrium income and full employment?*
- B. *The value of the multiplier is:*
- C. *Aggregate expenditures would have to be (increased or decreased?), and by how much, to eliminate the gap?*

- D. *The government could attempt to eliminate the gap by holding taxes constant and (increasing or decreasing ?) , expenditures by how much ?*
- E. *Alternatively , the government could attempt to eliminate the gap by holding expenditures constant and (increasing or decreasing ?) its tax receipts by how much ?*
- 7. *True , false , or uncertain , and explain why ? “ Regardless of our current economic situation , an increase in aggregate demand will always create new jobs . ”*

REAL AP MACRO FRQ s (05 B)

Section II Planning Time—10 minutes Writing Time—40 minutes each section

Directions: *You have fifty minutes to answer the three questions . It is suggested that you spend approximately half your time on the first question and divide the remaining time equally between the next two questions. In answering the questions, you should emphasize the line of reasoning that generated your results; it is not enough to list the results of your analysis. Include correctly labeled diagrams, if useful or required, in explaining your answers. A correctly labeled diagram must have all axes and curves clearly labeled and must show directional changes.*

1. Assume that a country’s economy is currently at equilibrium along an upward-sloping short-run aggregate supply curve. Suppose that the country’s central bank conducts an open-market sale of government bonds :

(a) Using a correctly labeled graph of the money market, show how the open-market sale of bonds will affect each of the following :

- (i) Money supply**
- (ii) Interest rate**

(b) Indicate whether the interest rate you identified in (a) (ii) is a real or a nominal rate.

(c) Under what condition will the nominal interest rate differ from the real interest rate?

(d) Using a correctly labeled graph of aggregate demand and aggregate supply, show the short-run effect of the open-market operation on each of the following :

- (i) Real output**
- (ii) Price level**

(e) On a correctly labeled graph of the Phillips curve, show how the open-market operation will affect the following in the short run. Use an arrow to show the direction of change :

- (i) Unemployment rate**
- (ii) Inflation rate**

(f) Identify a fiscal policy action that would offset the impact on real output and price level that you identified in (d).

2. Labor productivity is output per unit of labor. An increase in labor productivity is a source of economic growth.

(a) Identify two sources of increase in labor productivity.

(b) Assume that a country's economy is at full employment. Productivity has been rising. Using a correctly labeled graph of aggregate demand and aggregate supply, show the long-run effect of the growth in productivity on each of the following :

(i) Real output

(ii) Price level

(c) Assume that the economy produces only two goods, good X and good Y. Using a correctly labeled production possibility diagram, show the effect of the increase in labor productivity.

3. Assume that an increase in government spending increases the budget deficit in Country A.

(a) Using a correctly labeled graph of the loanable funds market, show the effect of the increase in Country A's budget deficit on the real interest rate.

(b) Given your answer in (a), what is the effect on business investment in Country A?

(c) The exchange rate between Country A's dollar and Country B's peso is determined in a flexible exchange market. Using a correctly labeled graph of the foreign exchange market for Country A's dollar, show how the interest rate change you identified in (a) affects the international value of Country A's dollar.

(d) Given your answer to (c), explain how the competitiveness of Country A's goods changes relative to Country B's goods.