2005 AP® MACROECONOMICS FREE-RESPONSE QUESTIONS

MACROECONOMICS

Section II

Planning time—10 minutes

Writing time—50 minutes

Directions: You have fifty minutes to answer all three of the following 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. Use a pen with black or dark blue ink.

1. Assume that the United States economy is currently in equilibrium at the full-employment level of real gross domestic product.

   (a) Draw a correctly labeled graph of aggregate demand and aggregate supply showing each of the following in the United States.

      (i) Output level

      (ii) Price level

   (b) Japan is a major importer of United States products. Assume that the Japanese economy goes into a recession.

      (i) Explain the impact of the Japanese recession on the United States equilibrium output and price levels.

      (ii) Show these effects on your graph in part (a).

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1. Assume that the United States economy is currently operating at an equilibrium below full employment.

   (a) Draw a correctly labeled graph of aggregate demand and aggregate supply, and show each of the following.

      (i) Long-run aggregate supply

      (ii) Current equilibrium output and price level

   (b) Now assume a significant increase in the world price of oil, a major production input for the United States. Show on your graph in part (a) how the increase in the oil price affects each of the following in the short run.

      (i) Short-run aggregate supply

      (ii) Real output and price level

   (c) Given your answer in part (b), explain what will happen to unemployment in the United States in the short run.

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1. Assume that Australia and New Zealand are trading partners. Australia's economy is currently in recession.

   (a) Now assume that Australia begins to recover from its recession. Using a correctly labeled graph of aggregate demand and aggregate supply for New Zealand, show the impact of Australia's rising income on each of the following in the short run.

      (i) Aggregate demand in New Zealand. Explain.

      (ii) Output in New Zealand

1. Assume that the United States economy is operating at less than full employment.
   (a) Using a correctly labeled aggregate demand and aggregate supply graph, show the following.
      (i) Full-employment output
      (ii) Current output
      (iii) Current price level

   (b) Suppose that no policy actions are taken to address the unemployment problem. With flexible prices and wages, explain how each of the following will eventually change.
      (i) Short-run aggregate supply
      (ii) Output and price level

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1. Assume that the United States economy is in a severe recession with no inflation.
   - (a) Using a correctly labeled aggregate demand and aggregate supply graph, show each of the following for the economy.
     - (i) Full-employment output
     - (ii) Current output level
     - (iii) Current price level
   - (b) The federal government announces a major decrease in spending. Using your graph in part (a), show how the decrease in spending will affect each of the following.
     - (i) Level of output
     - (ii) Price level
   - (c) Explain the mechanism by which the decrease in government spending will affect the unemployment rate.

1996 Macro Free Response

1. Suppose the following conditions describe the current state of the United States economy.

- Real gross domestic product is growing at the rate of 3 percent
- The inflation rate is 9 percent
- The unemployment rate is 2.5 percent

(a) Identify the main problem this economy faces.

(d) Congress votes to increase personal income taxes. Using aggregate demand-aggregate supply analysis, explain what effect this policy will have on each of the following.

(i) Output and employment
(ii) The price level
(iii) The interest rate