MEGA FUN SET 5.2

2004 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.

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) Identify an open-market operation that could restore full employment in the short run.

   (c) Using a correctly labeled graph of the money market, show how the open-market operation you identified in part (b) affects the interest rate in the short run.

   (d) Explain how the change in the interest rate you identified in part (c) will affect aggregate demand.

   (e) Show on the graph in part (a) how the change in the interest rate you identified in part (c) will affect output and price level.

   (f) Instead of the open-market operation in part (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

3. The Federal Reserve buys $5,000 in bonds from Clark Consulting Services, which then deposits the money in a checking account at First Generation Bank.

   (a) As a result of the Federal Reserve's action, what is the change in the money supply if the required reserve ratio is 100 percent?

   (b) If the required reserve ratio is reduced to 10 percent, calculate the following.

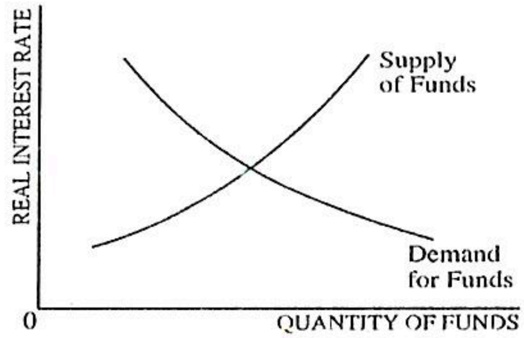
      (i) The maximum amount this bank could lend from this deposit

      (ii) The maximum increase in the total money supply from the Federal Reserve's purchase of bonds

   (c) If banks keep some of the deposit as excess reserves, how will this influence the change in the money supply that was determined in part (b)(ii)? Explain.

   (d) If the public decides to hold some money in the form of currency rather than in demand deposits, how will this influence the change in the money supply that was determined in part (b)(ii)? Explain.

2005 AP® MACROECONOMICS FREE-RESPONSE QUESTIONS



2. The graph above shows the loanable funds market for a country.
   (a) Assume that now the country's government increases deficit spending. Explain how the increase in deficit spending will affect the real interest rate.
   (b) Indicate how the real interest rate change you identified in part (a) will affect investment in plant and equipment.
   (c) Explain how the real interest rate change you identified in part (a) will affect long-term economic growth.
   (d) Explain how the real interest rate change you identified in part (a) will affect each of the following in the foreign exchange market.
      (i) The demand for the country's currency
      (ii) The value of the country's currency

2007 AP® MACROECONOMICS FREE-RESPONSE QUESTIONS

2. In recent years, the Federal Reserve has made targeting the federal funds rate a main focus of its monetary policy.
   (a) Define the federal funds rate.
   (b) If the Federal Reserve wants to lower the federal funds rate, what open-market operation would be appropriate?
   (c) Assume that the open-market operation that you indicated in part (b) is equal to $10 million. If the required reserve ratio is 0.2, calculate the maximum change in loans throughout the banking system.
   (d) Indicate the effect of the open-market operation that you indicated in part (b) on the nominal interest rate.
   (e) Assume that the Federal Reserve's action results in some inflation. What would be the impact of the open-market operation on the real rate of interest? Explain.

3. Indicate whether each of the following is counted in the United States gross domestic product for the year 2006. Explain each of your answers.
   (a) The value of a used textbook sold through an online auction in 2006
   (b) Rent paid in 2006 by residents in an apartment building built in 2000
   (c) Commissions earned in 2006 by a stockbroker
   (d) The value of automobiles produced in 2006 entirely in South Korea by a firm fully owned by United States citizens

U4 FRQ Practice Question -Fiscal/Monetary Policy

1. (a) Using a correctly labeled aggregate supply and aggregate demand graph, show the impact of a sudden, large decrease in private investment spending on each of the following.

    (i) Output

    (ii) Price level

   (b) Using the results in part (a), explain how employment is affected.

   (c) Identify one specific fiscal policy that might be implemented to offset the effects of the decrease in investment, and explain how the policy would affect each of the following in the short run.

    (i) Aggregate demand

    (ii) Output and the price level

    (iii) Real interest rates

   (d) Identify an open-market operation that the central bank might implement to offset the effects of the decrease in investment, and explain how the policy would affect each of the following in the short run.

    (i) Real interest rates

    (ii) Aggregate demand

    (iii) Output and the price level

   (e) If the central bank continues the open-market operation described in (d), explain the long-run effects on each of the following.

    (i) Inflation

    (ii) Value of the domestic currency in foreign exchange markets

FRQ

AS/AD---Interest Rates---Fiscal Policy

1. The economy is at full employment. An increase in government spending causes the government deficit to increase.

(a) Draw an aggregate supply and demand graph showing the economy at full employment. Show on the graph and explain completely the impact of the increase in government spending on each of the following.

(i) Price level

(ii) Real Output

(b) Explain how the increase in the deficit will affect each of the following in the long run.

(i) Nominal interest rates

(ii) Real interest rates

(c) Define each of the following

(i) Government deficit

(ii) National debt

(d) Do each of the following.

(i) Identify one tax policy the government could use to promote long-run economic growth in this economy.

(ii) Explain how this tax policy will promote long-run growth.

(iii) Draw a production possibilities curve for this economy that produces capital goods and consumption goods. Show how this tax policy will affect this economy's production possibilities curve.