AP Macroeconomics
2000 Student Samples

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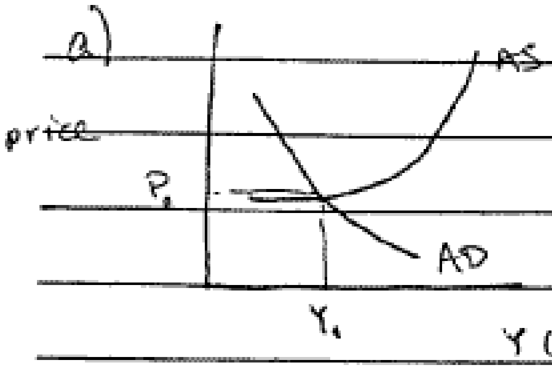
/ MACP1

a)



flat part of AS curve is where economy is running on low capacity - recession

b) Decreasing taxes or increasing gov't expenditures is part of expansionary fiscal policy; both policies result in increase of Y or GDP. However, increasing G will have a greater impact on GDP b/c in general, the gov't spending multiplier is greater than the tax multiplier. So the ΔY as a result of ΔG is greater than the ΔY resulting from ΔT, if $\Delta G = \Delta T$.

Ex) $MPS = .2$ $\quad MPC = .8$ $\quad \Delta G = \Delta T = 100$

gov't spending mult. $= \frac{1}{MPS} = \frac{1}{.2} = 5$

$\Delta Y =$ mult. $\cdot \Delta G = 5 \cdot \$100 = \$500$

tax multiplier $= -\frac{MPC}{MPS} = -\frac{.8}{.2} = -4$

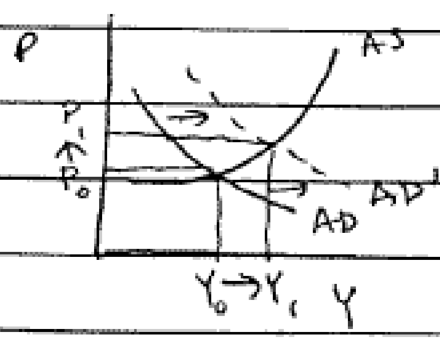
$\Delta Y =$ mult. $\cdot \Delta T = -4 \cdot -\$100 = \$400$

$\$400 < \$500$

cont. on p. 5

So $\uparrow G$ causes a greater increase in GDP than (tax cut) a tax cut does.

c)(i) Tax cut $\rightarrow$ increase in disposable income $\rightarrow$ increase in consumption & saving $\rightarrow AE\uparrow \rightarrow$ unplanned fall in inventory $\rightarrow$ production $\uparrow \rightarrow$ aggregate output $\uparrow$



ii Tax cut causes AD curve to shift (R) so GDP and price level increase.

(iii) Because consumers have more income and will consume more, they will buy more imports.

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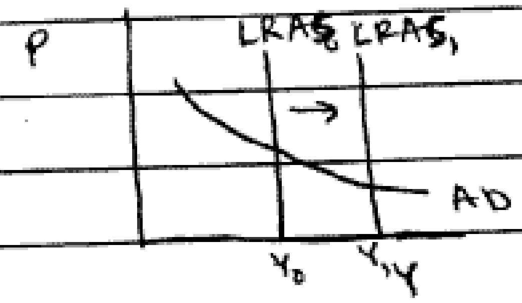
c) (iv) Because of the tax cut, the price level increased (see part ii). So US goods are more expensive abroad so foreigners will demand less US goods. Thus, US exports fall.

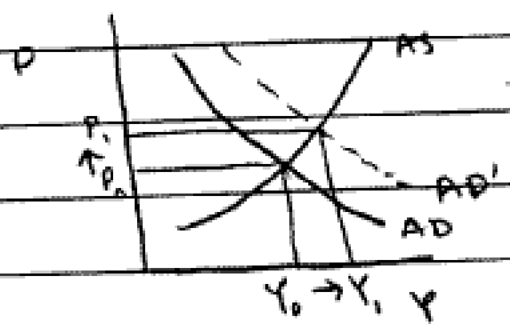
d) (ii) An increase in net investment means there is more capital in factories and firms which leads to greater productivity. Firms can produce more so the aggregate supply increases (shifts R)



(i) Each point on the aggregate demand curve is a point of equilibrium where aggregate expenditure equals aggregate output or income) so

$$Y = \underbrace{C + I + G}_{AE}$$

An increase in investment causes AE↑ and in order to keep equilibrium, Y will increase as well. So the AD curve shifts R (increases)



1 MACA

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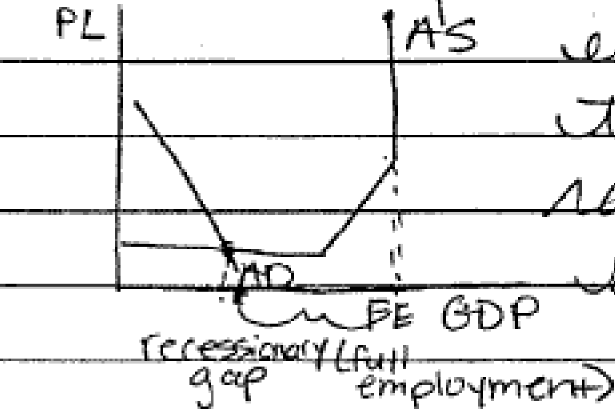
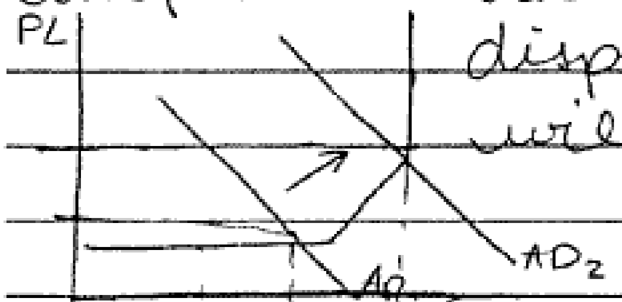
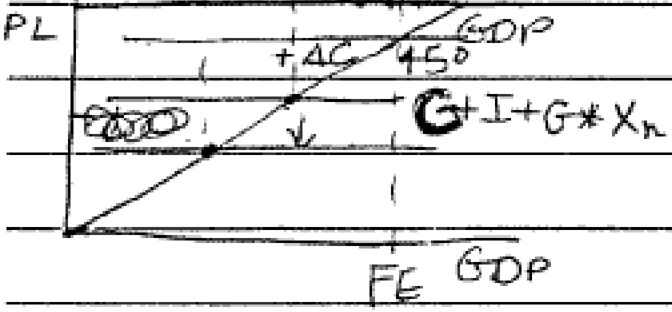
Ⓐ The US is in a recession, so the AD line intersects the AS curve in the Keynesian range. The economy faces problems of high unemployment, low GDP growth and a low price level. Ⓑ If Congress takes an



expansionary monetary policy, they should decrease taxes rather than increase government spending. Although both will increase aggregate demand,

~~only~~ lowering taxes will have the biggest impact. Since lowering taxes increases consum disposable income, consumption will increase. Consumption is the largest component of GDP, therefore GDP will increase more if C is increased rather than government spending. Thus aggregate demand will increase by more.





Also increasing G will cause a deficit, raising the interest rates and crowding out business investments.

Ⓒ A decrease in personal taxes will not only raise ~~[illegible]~~ consumption, but will consequently raise the real GDP and price level by increasing GDP and increasing AD (see above graph). Since the price level rises, it will cause US goods to become more expensive to foreign purchasers, so our exports will decrease.

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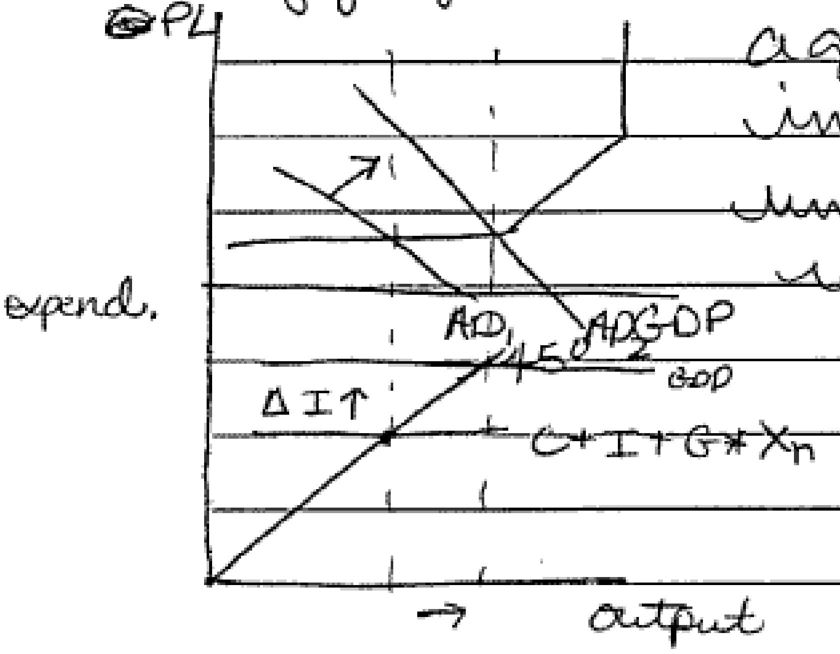
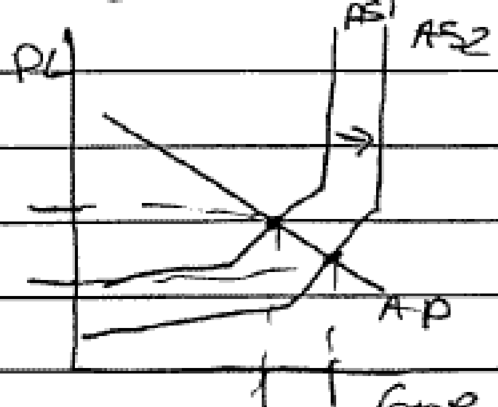
Net imports will raise, since foreign goods will be relatively cheaper. Thus net exports (X_n) will fall. (D) An increase in net investment will increase GDP and aggregate demand. An increase in aggregate demand will increase output, decrease unemployment and possibly raise the price level.



(see graph). A change in I will not effect aggregate supply. The supply will only be changed by a change in the labor force or other resources. It could also be changed by productivity or new technology. However if an increase in business investment results in purchase of better equipment and capital that will in turn ↑ productivity and lower production costs, then AS will increase. This increase will lower unemployment, raise output, while maintaing or lowering the price level.



IMAC II

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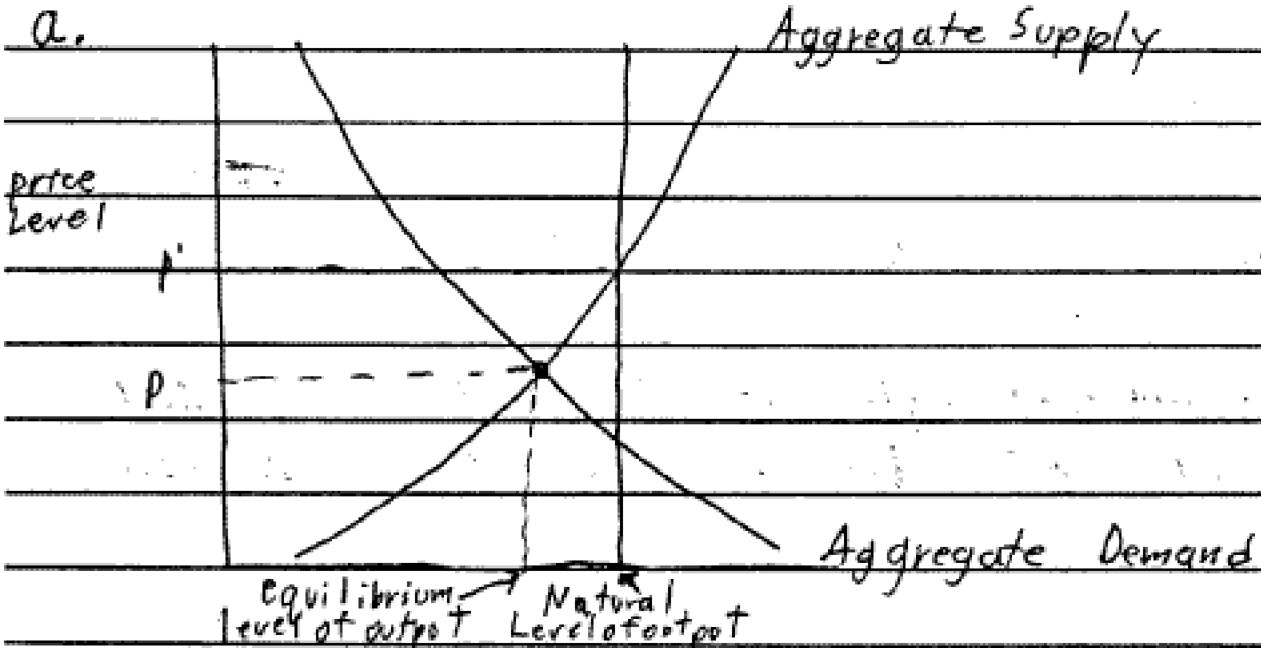
a.



B. Increasing government purchases will have a larger impact on GDP. The reason is, because government purchases ~~will~~ can be spent in ways that would increase output by the maximim amount. Consumers on the other hand, would spend their extra money from a tax decrease on things that might not increase on Real Gross Domestic Product at all.

c. i. Consumption would increase because people would have more money to spend.

ii. Real GDP would increase because more money would be spent on consumption (C), also, the price level would rise because the AD curve would shift to the right and inersect the AS curve higher up.

iii. Imports would decrease because the dollar would be worth less.

iv. Exports would increase because foreigners could buy domesticly produced goods for a cheaper price.

d. i. Aggregate demand will rise because because goods will be cheaper.

ii. LRAS will rise because goods will be produced cheaper and more efficently. because of the investment in plants and equipment.