AP® Macroeconomics
2002 Free-Response Questions

These materials were produced by Educational Testing Service® (ETS®), which develops and administers the examinations of the Advanced Placement Program for the College Board. The College Board and Educational Testing Service (ETS) are dedicated to the principle of equal opportunity, and their programs, services, and employment policies are guided by that principle.

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. The United States is experiencing a high rate of unemployment.

   (a) Identify one fiscal policy action that Congress might initiate to decrease the unemployment rate.

   (b) Assume that the policy you identified in part (a) reduced unemployment, but the economy is still operating below full employment. Using a correctly labeled aggregate demand-aggregate supply graph, show and explain how the action you identified would affect each of the following.

      (i) Output

      (ii) Price level

   (c) Explain how the policy you identified in part (a) would affect short-term interest rates.

   (d) Given that the economy is still below full employment, identify the open market policy the Federal Reserve could implement to increase the money supply.

   (e) Using correctly labeled graphs, show and explain how the increase in money supply will affect each of the following in the short run.

      (i) Short-term interest rates

      (ii) Output

      (iii) Price level

GO ON TO THE NEXT PAGE.

2. Explain how each of the following will affect long-run aggregate supply (potential real gross domestic product).

   (a) A decrease in the labor force participation rate
   (b) An increase in the government deficit following a reduction in personal income taxes
   (c) A decrease in the quantity of inputs required to produce a unit of output
   (d) An increase in the quantity and quality of education
   (e) An increase in the rate of savings

3. Initially, the real interest rates in the United States and Japan are equal to 7 percent. The real interest rate in the United States increases to 8 percent while the real interest rate in Japan decreases to 6 percent.

   (a) How and why will capital flows be affected by this change in real interest rates?

   (b) Using a correctly labeled graph for the yen market, show and explain how the value of the yen will change relative to the value of the dollar.

   (c) Explain how the change in the value of the yen will affect each of the following in the United States.

      (i) Imports from Japan

      (ii) Exports to Japan

END OF EXAMINATION