Name: ________________________

AP Macroeconomics Problem Set #3
Aggregate Demand, Aggregate Supply and Fiscal Policy

1. (____/35) **Aggregate Demand and Aggregate Supply**
   a. Define and give examples of the determinants of aggregate demand. (____/10)
   b. Define and give examples of the determinants of aggregate supply. (____/10)
   c. Define sticky vs. flexible wages and prices. (____/5)
   d. Graph the following curves (on the same graph): AD, SRAS and LRAS. Make sure to correctly label the axes. (____/10)

2. (____/20) **Key Concepts**
   Define and explain each concept and give specific examples:
   a. The Multiplier Effect and Spending Multiplier (____/10)
   b. Crowding Out (____/5)
   c. A Built-in Stabilizer (____/5)

3. (_____/8) **Macroeconomic Equilibrium**
   What causes each of the following?
   a. An increase in AD? (____/2)
   b. A decrease in AD? (____/2)
   c. An increase in AS? (____/2)
   d. A decrease in AS? (____/2)

4. (____/15 Points) **Fiscal Policy**
   a. Explain the difference between expansionary and contractionary fiscal policies. Explain their goals and give specific examples. (____/10)
   b. To support your answer in part a, draw a recessionary gap and an inflationary gap. Draw and explain how fiscal policy is used to close the gaps using accurate numbers. (____/5)

5. (____/22 Points) **Practice Free Response Questions**
   Complete the attached FRQs. Make sure to fully explain when asked
   FRQ #1: (____/10)
   FRQ #2: (____/5)
   FRQ #3: (____/7)

AD/AS PRACTICE

Name:________________________________

The Change	**AD/AS Model**	**The Result**
1. Calvin, and other children, convince their parents to purchase more "big ticket" items for the Holidays.		**1. Before: A** **2. Shifter** **3. After: B** **4. Gap:**
2. The effect on production when a 5% excise tax is placed on several resources.		**1. Before: A** **2. Shifter** **3. After: B** **4. Gap:**
3. A large purchase of U.S. wheat by Russia		**1. Before: A** **2. Shifter** **3. After: B** **4. Gap:**
4. A cut in Federal spending for Health Care		**1. Before: A** **2. Shifter** **3. After: B** **4. Gap:**
5. The complete disintegration of OPEC causing oil prices to fall		**1. Before: A** **2. Shifter** **3. After: B** **4. Gap:**
6. A 10% decrease in personal income tax rates		**1. Before: A** **2. Shifter** **3. After: B** **4. Gap:**

AD/AS PRACTICE SHEET

The Change	**AD/AS Model**	**The Result**
7. A significant increase in labor productivity		**1. Before: A** **2. Shifter** **3. After: B** **4. Gap:**
8. A severe recession in a country that imports many U.S. products.		**1. Before: A** **2. Shifter** **3. After: B** **4. Gap:**
9. The effect on investment when the government increases the money supply causing interest rates to fall.		**1. Before: A** **2. Shifter** **3. After: B** **4. Gap:**
10. Widespread fear of depression on the part of consumers		**1. Before: A** **2. Shifter** **3. After: B** **4. Gap:**
11. To stimulate the economy, the government increases spending on public works programs.		**1. Before: A** **2. Shifter** **3. After: B** **4. Gap:**
12. A 12% decrease in nominal wages.		**1. Before: A** **2. Shifter** **3. After: B** **4. Gap:**

1.

Assume that the economy is operating below the full-employment level of output and that the government's budget is balanced.

(a) Using a correctly labeled aggregate demand and aggregate supply graph, show how an increase in government spending will affect each of the following in the short run.

(i) Real output

(ii) Price level

(b) Explain how this increase in government spending will affect each of the following in the short run.

(i) Real interest rates

(ii) Investment

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.

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.