

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)

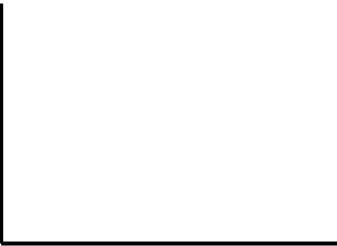



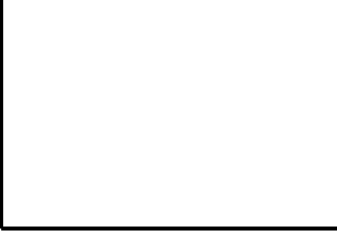

FRQ #3: (____/7)

AD/AS PRACTICE

Name: _____

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

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.