

1999

The College Board

Advanced Placement Examination

MACROECONOMICS

Planning Time – 10 minutes

Writing Time – 50 minutes

**Directions:** You have 50 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 diagrams, if useful or required, in explaining your answers. All diagrams should be clearly labeled.

**Question 1**

Following an increase in the demand for money, an open economy is experiencing a significant increase in real interest rates relative to the rest of the world.

- a. Explain how this increase in interest rates will affect each of the following for the country.
  - i. Investment
  - ii. The international value of its currency
  - iii. Exports
- b. Using a correctly labeled aggregate demand and aggregate supply diagram, show how the change in investment you identified in part (a) will affect each of the following in the short run.
  - i. Output
  - ii. The price level
- c. Identify one fiscal policy action that could counter the effects identified in part (b). Explain how this policy will affect each of the following.
  - i. Output
  - ii. The price level
  - iii. Nominal interest rates
  - iv. The price of bonds
- d. Identify one monetary policy action that could counter the effects identified in part (b). Using a correctly labeled money market graph, show how this policy will affect nominal interest rates.

## Question 2

Assume an open economy with a public sector.

- Identify two methods of calculating gross domestic product for this economy.
- Explain why the two methods you identified in part (a) must yield the same value of gross domestic product.
- Identify one shortcoming of using gross domestic product as an indicator of the actual level of national output.
- If nominal gross domestic product increased by 4 percent in 1996, identify two additional pieces of information you need before you can conclude that the living standard of the typical person increased by 4 percent during that year.

## Question 3

Assume that an economy is at full employment.

- a. Explain how an increase in net investment will affect each of the following.
  - i. Aggregate demand
  - ii. Capital stock
  - iii. Long-run aggregate supply
  - iv. Output
- b. Explain how the increase in net investment will affect the country's production possibilities curve shown below.

