



**AP<sup>®</sup> Macroeconomics  
2004 Free-Response Questions  
Form B**

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**2004 AP<sup>®</sup> MACROECONOMICS FREE-RESPONSE QUESTIONS (Form B)**

**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. Assume that a country's economy is in equilibrium.
  - (a) Using a correctly labeled aggregate demand and aggregate supply graph, show how an increase in the price of oil, an important natural resource, will affect the following in the short run.
    - (i) Real output
    - (ii) Price level
  - (b) Using a correctly labeled graph, show how the increase in the price of oil affects the short-run Phillips curve.
  - (c) Assume that the central bank of the country responds to the higher price of oil by increasing the money supply.
    - (i) Explain the process by which the increase in the money supply will affect the aggregate demand in the short run.
    - (ii) Indicate how the increase in the money supply will affect real output and the price level.
  - (d) Now assume that instead of using monetary policy in response to the oil price increase, the government reduces business taxes, which results in lower production costs. Using a new correctly labeled graph, show the effect of the reduction in business taxes on the following.
    - (i) Real output
    - (ii) Price level

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**GO ON TO THE NEXT PAGE.**

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2. Due to an international financial crisis, Canada experiences a significant inflow of funds from other countries. Explain the effect that this inflow of funds will have on the following.
- (a) The international value of the Canadian dollar
  - (b) Canadian net exports
  - (c) The real interest rate in Canada
  - (d) The level of investment in Canada
- 

| OUTPUT PER WORKER PER DAY |                |               |
|---------------------------|----------------|---------------|
| Country                   | Units of Cloth | Units of Food |
| Newland                   | 10             | 2             |
| Beeland                   | 10             | 1             |

3. The table above gives the production alternatives of two nations that are producing cloth and food, using equal amounts of resources.
- (a)
    - (i) Calculate the opportunity cost of producing a unit of cloth in Newland.
    - (ii) Calculate the opportunity cost of producing a unit of food in Beeland.
  - (b)
    - (i) Which nation has the comparative advantage in cloth production?
    - (ii) Which nation has the comparative advantage in food production?
  - (c) Now assume that the productivity of Beeland's workers triples for each good.
    - (i) Which country has a comparative advantage in food production?
    - (ii) Explain how you determined your answer.

**END OF EXAMINATION**