Sample Long Free-Response Questions

1. Assume you are a member of Congress. A member of your staff has just given you the following economic statistics:

	Year Ago Quarter	Last Quarter	Estimate for Quarter Now Ending
Real gross domestic product (in billions of 1997 dollars)	$2,789	$2,689	$2,598
Consumer price index	197	201	204
Unemployment rate	5%	8%	10.2%
Gross private investment (in billions of 1997 dollars)	$312	$300	$287

(A) What economic problem is this nation facing?

(B) Identify the fiscal policy actions you would recommend.

(C) What are the goals of your fiscal policy actions?

(D) Explain how each policy action you identified in Question 1(B) will fit the goals you stated in Question 1(C).

(E) Use a correctly labeled aggregate demand and aggregate supply graph to show the effects of your fiscal policy on the economy. Show the changes that will occur in the price level and the level of real GDP.

2. Assume you are a member of Congress. A staff member has just given you the following economic statistics:

	Year Ago Quarter	Last Quarter	Estimate for Quarter Now Ending
Real gross domestic product (in billions of 1997 dollars)	$2,356	$2,589	$2,752
Consumer price index	210	240	250
Unemployment rate	10%	6.5%	5.1%
Gross private investment (in billions of 1997 dollars)	$312	$340	$352

(A) What economic problem is this nation facing?

(B) Identify the fiscal policy actions you would recommend.

(C) What are the goals of your fiscal policy actions?

(D) Explain how each policy action you identified in Question 2(B) will fit the goals you stated in Question 2(C).

(E) Use a correctly labeled aggregate demand and aggregate supply graph to show the effects of your fiscal policy on the economy. Show the changes that will occur in the price level and the level of real GDP.

3. Assume that the economy has been operating at the full-employment levels of output and employment but has recently experienced a decrease in consumption spending because of a sharp decline in stock market indexes that has reduced the wealth of the nation by about 18 percent. Consumption expenditures have decreased at all levels of income.

   (A) Use correctly labeled aggregate demand and aggregate supply graphs to illustrate the short-run effect of the decrease in consumption expenditures on each of the following:

   (i) Output

   (ii) Employment

   (iii) The price level

(B) Identify two fiscal policy actions that could be used to counter the effects of the initial decrease in consumption spending. Explain, using correctly labeled aggregate demand and aggregate supply graphs, the short-run effects of each of your policies on each of the following:

(i) Output

(ii) Employment

(iii) The price level

4. Assume that political problems restrict the supply of oil in international markets. Consequently, increased production costs result in the following economic conditions in the United States:
   - The unemployment rate is 8 percent and rising.
   - The CPI is rising 9 percent annually and accelerating.
   - The annual rate of growth of real GDP is –1.5 percent.

   (A) Identify and describe the major macroeconomic problems in the economy. Using correctly labeled aggregate demand and aggregate supply graphs, show the condition of the economy.

   (B) With a federal budget deficit of nearly $350 billion, fiscal authorities are considering the following policy actions to address the existing economic problems:

   Policy 1: Increase government expenditures.

   Policy 2: Increase personal income taxes.

   Policy 3: Decrease business taxes and regulations.

   Describe the effect of each of the policies on the economy, and demonstrate each on an individual aggregate demand and aggregate supply graph. Be sure to include each of the following in your description:
   (i) Output
   (ii) Employment
   (iii) The price level

Policy 1:

Policy 2:

Policy 3: