

Question 2

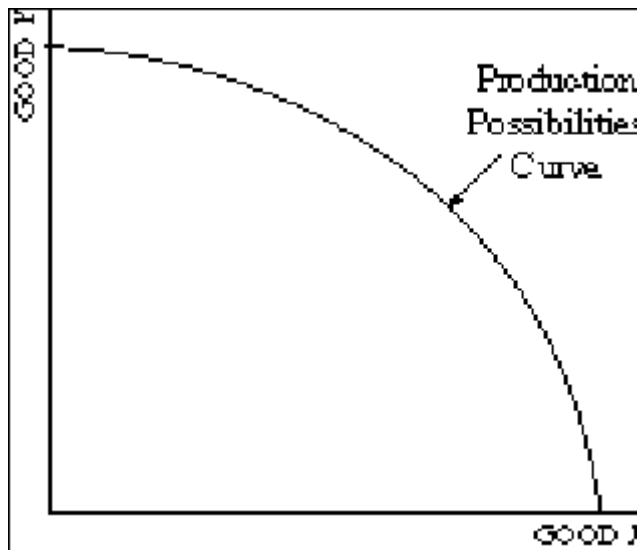
Assume an open economy with a public sector.

- 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.



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Question 3

Correct Answer

Part (a): Since net investment is a component of aggregate demand, the aggregate demand curve will shift to the right. With net investment occurring, the capital stock will increase. An increase in the capital stock will increase (shift out) the long-run aggregate supply function. The potential output of the economy increases. With the increase in aggregate demand and the increase in aggregate supply, real output increases.

Part (b): The increase in capital stock, a factor of production, will lead to an outward shift in the country's production possibilities curve.

Scoring Rubrics:

Part (a) = 4 points, Part (b) = 1 point; 5 Points in Total

Part (a): One point each

- (i) AD increases because net investment is a component of AD
- (ii) Capital stock increases as a result of net investment
- (iii) Long-run aggregate supply increases (shifts to the right) with the increase in capital stock.
- (iv) Output increases because aggregate demand and long-run aggregate supply both increase

Part (b): One point

The production possibilities curve shifts outward because there has been an increase in the capital stock.