2004-05 Course Outline

AP® Macroeconomics

The purpose of an AP® course in macroeconomics is to give students a thorough understanding of the principles of economics that apply to an economic system as a whole. Such a course places particular emphasis on the study of national income and price-level determination, and also develops students' familiarity with economic performance measures, the financial sector, stabilization policies, economic growth, and international economics. There is no single approach that an AP Macroeconomics course is expected to follow. Whatever the approach, however, AP teachers are advised to take into account certain topics generally covered in college courses. The following is a brief discussion of these topics and some aspects of them that a teacher may choose to explore.

Topics

I. Basic Economic Concepts

A macroeconomics course introduces students to fundamental economic concepts such as scarcity and opportunity costs. Students understand the distinction between absolute and comparative advantage and apply the principle of comparative advantage to determine the basis on which mutually advantageous trade can take place between individuals and/or countries and to identify comparative advantage from differences in opportunity costs. Other basic concepts that are explored include the functions performed by an economic system and the way the tools of supply and demand are used to analyze the workings of a free market economy. The course should also introduce the concept of the business cycle to give students an overview of economic fluctuations and to highlight the dynamics of unemployment, inflation, and economic growth. Coverage of these concepts provides students with the foundation for a thorough understanding of macroeconomic concepts and issues.

II. Measurement of Economic Performance

To provide an overview of how the economy works, the course should start with a model of the circular flow of income and products that contains the four sectors: households, businesses, government, and international. It is important to identify and examine the key measures of economic performance: gross domestic product, unemployment, and inflation.

In studying the concept of gross domestic product, it is also important that students learn how gross domestic product is measured, have a clear understanding of its components, and are able to distinguish between real and nominal gross domestic product.

The course should examine the nature and causes of unemployment, the costs of unemployment, and how the unemployment rate is measured, including the criticisms associated with the

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measurement of the unemployment rate. It is also important to understand the concept of the natural rate of unemployment and the factors that affect it. Students should also have an understanding of inflation and how it is measured. In this section, the course should cover the costs of inflation, the main price indices such as the consumer price index (CPI), and the gross domestic product deflator. Students should learn how these indices are constructed and used to convert nominal values into real values, as well as to convert dollar values in the past to dollar values in the present. It is also important to highlight the differences between the two price indices as a measure of inflation, as well as the problems associated with each measure.

III. National Income and Price Determination

This section introduces the aggregate-supply and aggregate-demand model to explain the determination of equilibrium national output and the general price level, as well as to analyze and evaluate the effects of public policy. It is important to discuss the aggregate-demand and aggregate-supply concepts individually to provide students a firm understanding of the mechanics of each.

The aggregate demand and aggregate supply analysis often begins with a general discussion of the nature and shape of the aggregate demand and aggregate supply curves and the factors that affect them. A detailed study of aggregate demand may begin by defining the four components: consumption, investment, government spending, and net exports. It also examines why the aggregate demand curve slopes downward and how changes in the determinants affect the aggregate demand curve. The spending-multiplier concept and its impact on aggregate demand, and how crowding out lessens this impact, should be demonstrated as well. The course can then present the definition and determinants of aggregate supply, the different views about the shape of the aggregate supply curve in the short run and in the long run, and highlight the importance of the shape in determining the effect of changes in aggregate demand on the economy. It is also important to understand the notion of sticky-price and sticky-wage models and their implication for the aggregate supply curve in comparison to flexible prices and wages.

Students should be able to use the aggregate-demand and aggregate-supply model to determine equilibrium income and price level, and to analyze the impact of economic fluctuations on the economy's output and price level, both in the short run and in the long run.

IV. Financial Sector

To understand how monetary policy works, students must understand the definitions of both money supply and money demand and the factors that affect each of them. Here the course introduces students to the definition of money and other financial assets such as bonds and stocks, the time value of money, measures of the money supply, fractional reserve banking, and the Federal Reserve System. In presenting the money supply, it is important to introduce the process of multiple-deposit expansion and money creation using T-accounts, and the use of the money multiplier. In learning about monetary policy, it is important to define money demand and examine its determinants. Having completed the study of money supply and money demand, the course should proceed to investigate how equilibrium in the money market determines the

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equilibrium interest rate, how the investment demand curve provides the link between changes in the interest rate and changes in aggregate demand, and how changes in aggregate demand affect real output and price level. Students should have an understanding of financial markets and the working of the loanable funds market in determining the real interest rate. It is important that students develop a clear understanding of the differences between the money market and the loanable funds market.

Having an understanding of the financial markets, students should identify and examine the tools of central bank policy and their impact on the money supply and interest rate. Students should understand the distinction between nominal and real interest rate. Students should also be introduced to the quantity theory of money, and examine and understand the effect of monetary policy on real output growth and inflation.

V. Inflation, Unemployment, and Stabilization Policies

Public policy affects the economy's output, price level, and level of employment, both in the short run and in the long run. Students should learn to analyze the impacts of fiscal policy and monetary policy on aggregate demand and on aggregate supply, as well as on the economy's output and price level both in the short run and in the long run. It is important for students to understand how an economy responds to a short-run shock and adjusts to long-run equilibrium in the absence of any public policy actions.

With both monetary and fiscal policies now incorporated in the analysis of aggregate demand and aggregate supply, an understanding of the interactions between the two is essential. Students should also examine the economic effects of government budget deficits, including crowding out, consider the issues involved in determining the burden of the national debt, and explore the relationships between deficits, interest rates, and inflation. The course should distinguish between the short-run and long-run impacts of monetary and fiscal policies and trace the short-run and long-run effects of supply shocks. Short-run and long-run Phillips curves are introduced to help students gain an understanding of the inflation-unemployment trade-off and how this trade-off may differ in the short and long run. In this section, the course identifies the causes of inflation and illustrates them by using the aggregate demand and aggregate supply model. A well-rounded course also includes an examination of the significance of expectations, including inflationary expectations.

VI. Economic Growth and Productivity

The course should introduce the framework and examine how long-run economic growth occurs. Students should understand the role of productivity in raising real output and the standard of living, and the role of investment in human capital formation and physical capital accumulation, research and development, and technical progress in raising productivity. Having learned the determinants of growth, students should examine how public policies influence the long-run economic growth of an economy.

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VII. Open Economy: International Trade and Finance

An open economy interacts with the rest of the world both through the goods market and the financial markets, and it is important to understand how a country's transactions with the rest of the world are recorded in the balance of payments accounts. Students should understand the meaning of trade balance, the distinction between the current account balance and the capital account balance, and the implications for the foreign exchange market.

The course should also focus on the foreign exchange market and examine how the equilibrium exchange rate is determined. Students should understand how market forces and public policy affect currency demand and currency supply in the foreign exchange markets and lead to currency appreciation or depreciation. How capital flows affect exchange rates, and how appreciation or depreciation of a currency affects a country's net exports should be an integral part of the presentation. Having learned the mechanics of the foreign exchange markets, students should then understand how changes in net exports and capital flows affect financial and goods markets.

It is important to examine what the effects of trade restrictions are, how the international payments system hinders or facilitates trade, how domestic policy actions affect international finance and trade, and how international exchange rates affect domestic policy goals.

Summary Outline

The following is a summary outline of the major content areas covered by the AP Examination in Macroeconomics. The percentages indicated reflect the approximate weight devoted to each content area in the multiple-choice section of the examination. The outline is a guide and is not intended as an exhaustive list of topics.

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AP® MACROECONOMICS EXAMINATION CONTENT SPECIFICATIONS

	Percentage Goals for Examination (multiple-choice section)
I. Basic Economic Concepts	**(8–12%)**
A. Scarcity, choice, and opportunity costs	
B. Production possibilities curve	
C. Comparative advantage, specialization, and exchange	
D. Demand, supply, and market equilibrium	
E. Macroeconomic issues: business cycle, unemployment, inflation, growth	
II. Measurement of Economic Performance	**(12–16%)**
A. National income accounts (4-6%)	
1. Circular flow	
2. Gross domestic product	
3. Components of gross domestic product	
4. Real versus nominal gross domestic product	
B. Inflation measurement and adjustment (4-5%)	
1. Price indices	
2. Nominal and real values	
3. Costs of inflation	
C. Unemployment (4-5%)	
1. Definition and measurement	
2. Types of unemployment	
3. Natural rate of unemployment	
III. National Income and Price Determination	**(15–25%)**
A. Aggregate demand (5-8%)	
1. Determinants of aggregate demand	
2. Multiplier and crowding-out effects	
B. Aggregate supply (5-8%)	
1. Short-run and long-run analyses	
2. Sticky versus flexible wages and prices	
3. Determinants of aggregate supply	
C. Macroeconomic equilibrium (5-8%)	
1. Real output and price level	
2. Short and long run	
3. Actual versus full-employment output	
4. Economic fluctuations	

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IV. Financial Sector **(10–20%)**

A. Money, banking, and financial markets (7-15%)
   1. Definition of financial assets: money, stocks, bonds
   2. Time value of money
   3. Measures of money supply
   4. Banks and creation of money
   5. Money demand
   6. Money market
   7. Loanable funds market

B. Central bank and control of the money supply (3-5%)
   1. Tools of central bank policy
   2. Quantity theory of money
   3. Real versus nominal interest rates

V. Inflation, Unemployment, and Stabilization Policies **(20–30%)**

A. Fiscal and monetary policies (15-20%)
   1. Demand-side effects
   2. Supply-side effects
   3. Policy mix
   4. Government deficits and debt

B. Inflation and unemployment (5-10%)
   1. Types of inflation
      a) Demand-pull inflation
      b) Cost-push inflation
   2. The Phillips curve: short run versus long run
   3. Role of expectations

VI. Economic Growth and Productivity **(4–6%)**

A. Investment in human capital
B. Investment in physical capital
C. Research and development, and technological progress
D. Growth policy

VII. Open Economy: International Trade and Finance **(10–12%)**

A. Balance of payments accounts
   1. Balance of trade
   2. Current account
   3. Capital account

B. Foreign exchange market
   1. Demand for and supply of foreign exchange
   2. Exchange rate determination
   3. Currency appreciation and depreciation

C. Net exports and capital flows

D. Links to financial and goods markets

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