





Test Development

Top 10 AP Econ Mistakes

2008

Overview

11. Compare MSC, MSB
10. Tax \rightarrow \uparrow MC \rightarrow \downarrow Q
9. Foreign Exchange Market with Shift
8. Automatic Stabilizers
7. Optimal Consumption Rule
6. Number of Firms Can't Increase in SR
5. Currency Appreciation from Real Interest Rate \uparrow
4. Current Account Changes Resulting from Real Income Changes
3. Link between Growth and Capital
2. Elements of the Current and Capital Account
1. Effects of a Lump Sum Subsidy

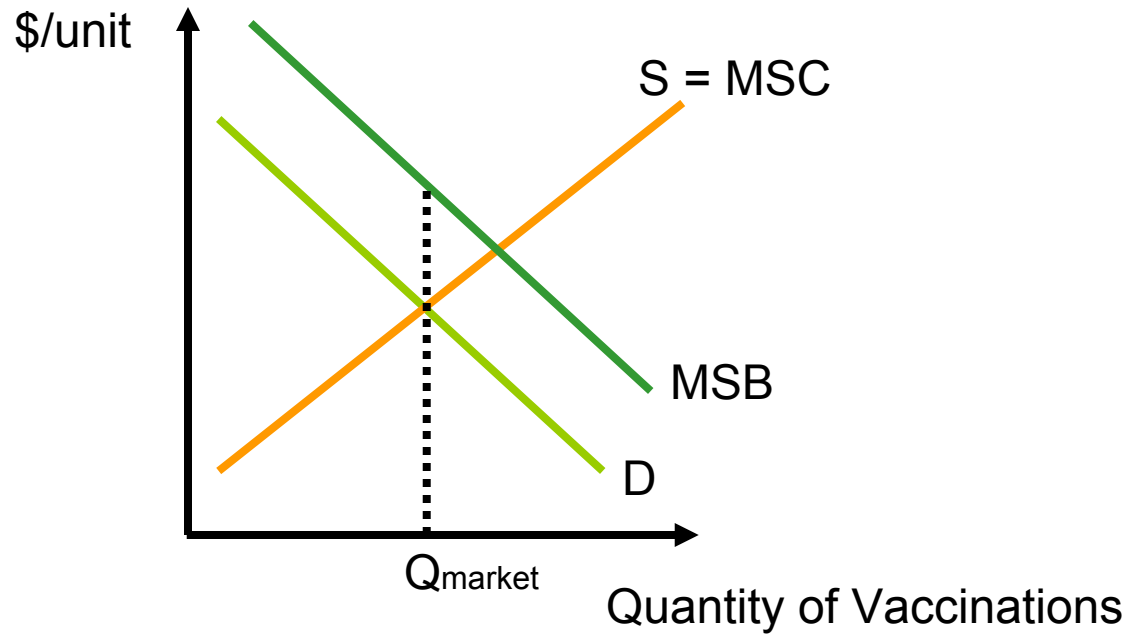
11. Overseas Micro 2 (b)

Question: [In a competitive market for vaccinations, which benefit consumers as well as others ...] Is marginal social cost greater than, less than, or equal to marginal social benefit at the market output?

Answer: $MSC < MSB$

32% Answered correctly

The Graph (not required for part b)





10. Overseas Micro 2 (c)

Question: How will a tax on producers of the vaccines affect the deadweight loss that you identified in part (a) (iii)? Explain.

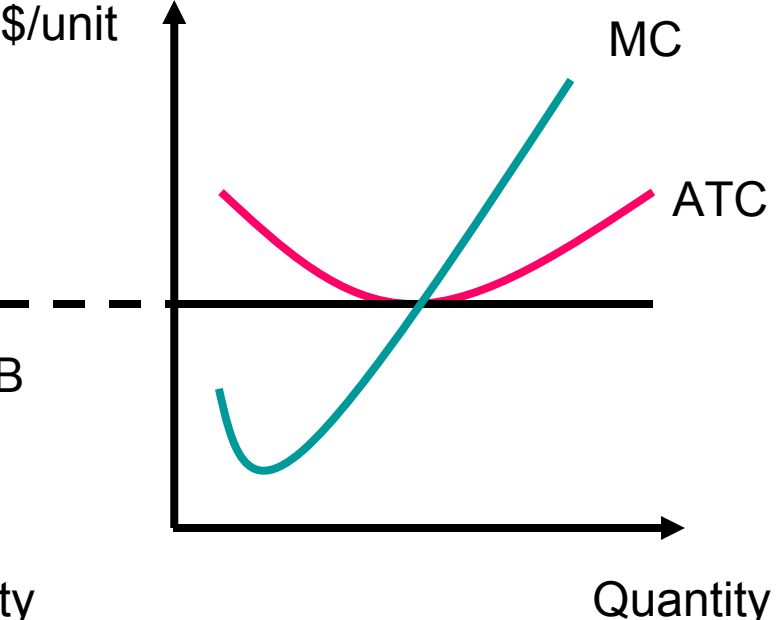
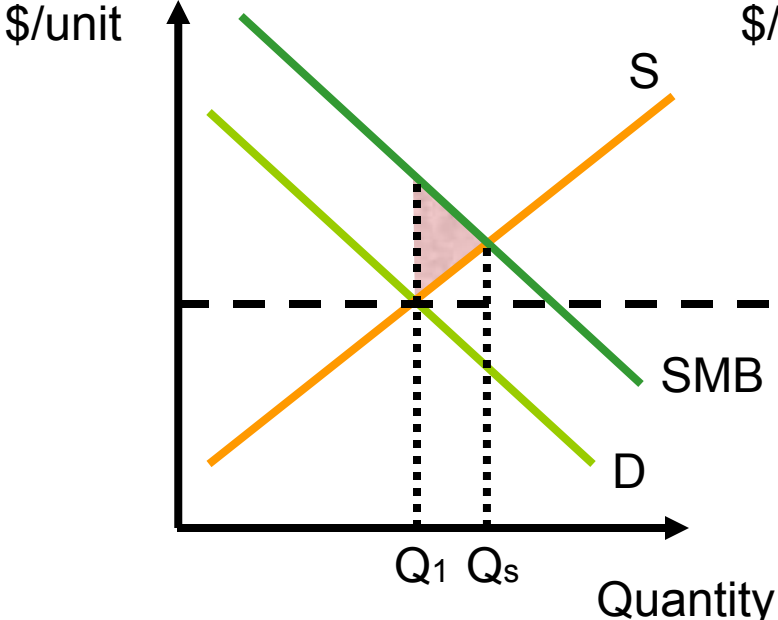
Answer: Deadweight loss increases

(64 percent answered correctly)

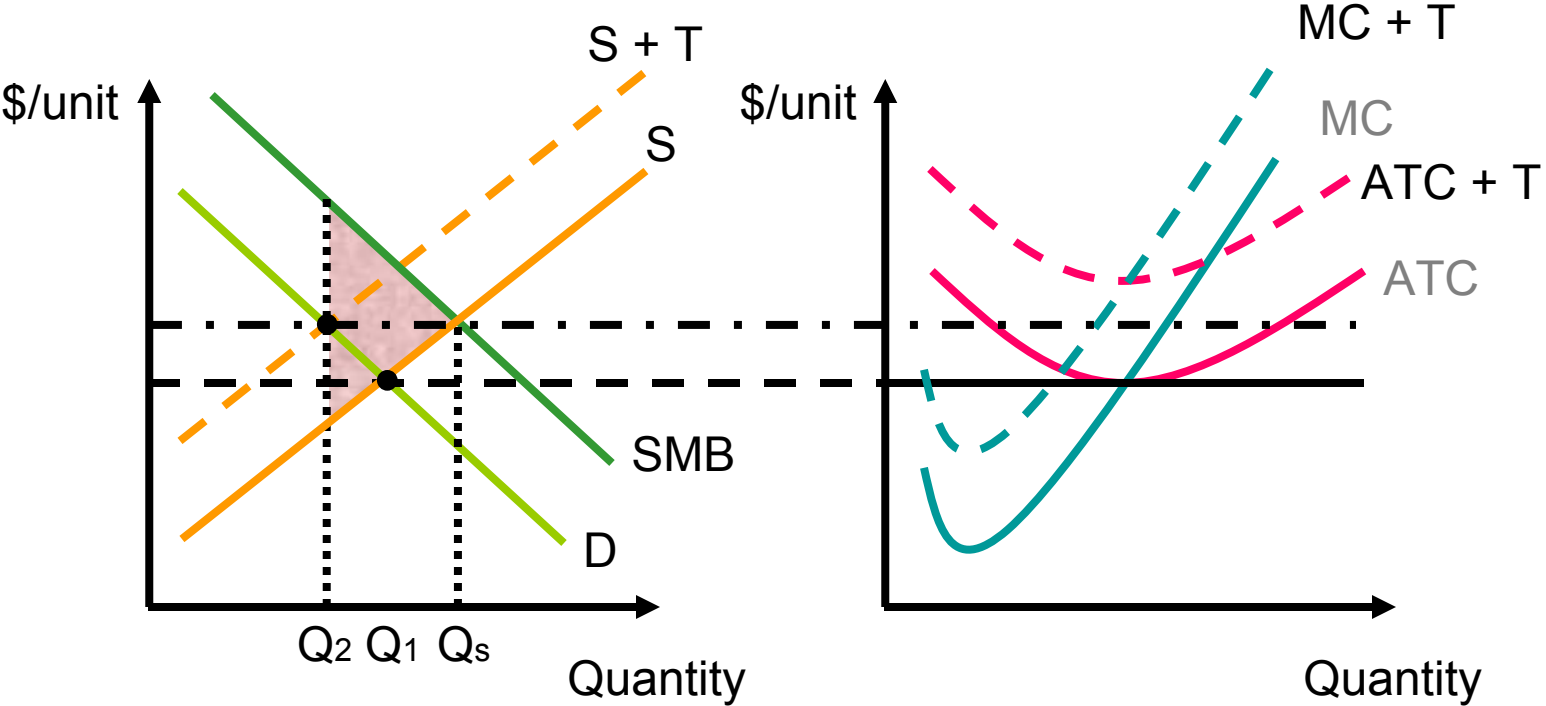
because the tax increases costs and causes output of the vaccine to fall.

(31% percent answered correctly)

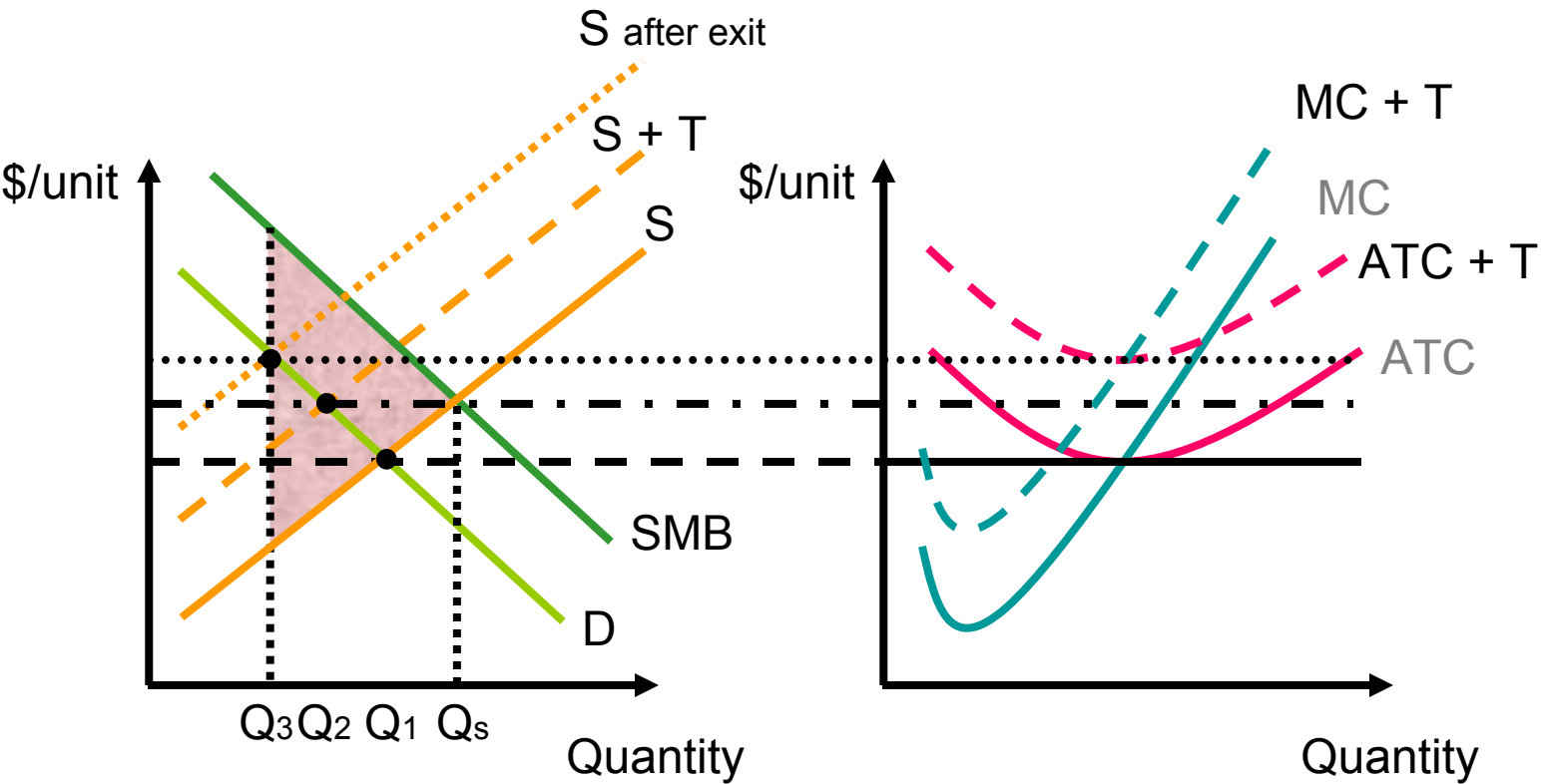
The Graph (not required for part c)



The Graph (not required for part c)



The Graph (not required for part c)



9. Macro 2 (c)

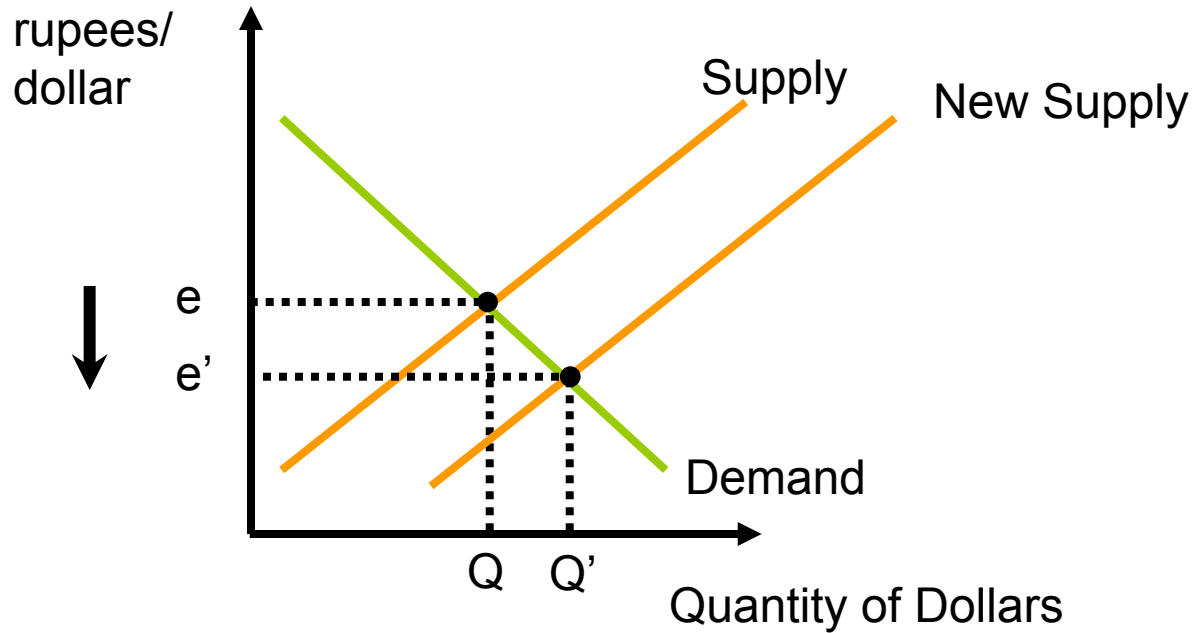
Question: Using a correctly labeled graph of the foreign exchange market for the U.S. dollar, show how an increase in U.S. firms' direct investment in India will affect the value of the dollar relative to the rupee.

Answer: In the dollar market, the supply of dollars will increase as dollars are exchanged for rupees, shifting the dollar supply curve to the right and decreasing the value of the dollar.

33% drew the graph correctly

29% shifted S correctly

The Graph



8. Macro 1 (b)

Question: [Starting with a balanced budget] What is the impact of the recession on the federal budget?

Answer: There will be a deficit because government spending / transfer payments increase and/or taxes fall due to **automatic stabilizers** (for example, unemployment insurance). Discretionary fiscal or monetary policy not accepted, for such answers violate the *ceteris paribus* assumption.

81% correctly indicated a deficit

27% indicated awareness of automatic stabilizers

7. Micro 2 (b)

Question: Should Mandy purchase more fudge and less coffee, purchase more coffee and less fudge, or maintain her current consumption? Explain.

	Fudge	Coffee
Quantity	10 lbs	7 lbs
Price per lb.	\$2	\$4
MU of last lb.	12	20

Answer: Mandy should purchase more fudge and less coffee because the MU/\$ of fudge (6) is greater than the MU/\$ of coffee (5).

44% said more fudge

26% gave the correct reason

6. Micro 1 (b) iii

Question: Indicate the effect the lump-sum subsidy to firms would have on the number of firms in the industry in the short run.

Answer: No effect. (The number of firms won't increase in the short run.)

25 percent answered correctly

5. Overseas Macro 1 (d) ii

Question: Given the [increase] in the real interest rate in part (c), what will be the effect on the value of Z's currency?

Answer: Z's currency will increase in value (because the higher real interest rate attracts more financial investment in Z, thus increasing the demand for Z's currency and decreasing the supply).

23% answered correctly



4. Macro 2 (b)

Question: How would an increase in the real income of the United States affect the U.S. current account balance? Explain.

Answer: The current account balance will decrease or move toward a deficit

(15 percent answered correctly)

because the increase in real income causes imports to increase relative to exports. (33 percent answered correctly)

3. Macro 1 (e)

Question: How will the real interest rate [increase] in part (d) affect the growth rate of the U.S. economy?

Answer: The growth rate will fall

(49 percent answered correctly)

because a higher real interest rate discourages investment and as a result, **capital** formation will decrease.

(12 percent answered correctly)

2. Macro 2 (a) ii

Question: Two major subaccounts in the balance of payments accounts are the current account and the capital account. In which of these subaccounts will the following be recorded?

(ii) A U.S. manufacturer buys computer equipment from Japan.

Answer: Current Account

10 percent answered correctly

1. Micro 1 (b) i

Question: Indicate the effect the lump-sum subsidy to all apple growers would have on a particular firm's quantity of output in the short run. Explain.

Answer: The lump-sum subsidy will have no effect on the firm's quantity of output in the short run (23 percent answered correctly) because it **does not affect MC or MR**, which determine the quantity of output.

9 percent answered correctly

More General Problems

- Poor labeling of lines and axes
- Sloppy writing
- Incorrect terminology

The budget is ...

- Dead
- Short
- Tipsy
- Crippled
- Softened
- Killed

Tip: Keep it simple: Increased/Decreased

Words Used (but perhaps not accepted) to Describe Increases or Decreases in Economic Growth

- Invigorated
- Refueled
- Retarded
- Limited
- Damaged
- Stagnated
- Dampened
- In Turmoil
- Slowed
- Stunted
- Constricted
- Negated
- Stifled
- Shrunk
- Suffered
- Dwindled
- Flourished
- Hurt
- Harmed
- Hindered
- Hampered

Game Theory

- Prisoners' Dilemma
- Battle of the Sexes
- Dominant Strategies
- Nash Equilibria

The Payoff Matrix

Pat

Chris

	Confess	Deny
Confess	5, 5	1, 10
Deny	10, 1	2, 2

The Payoff Matrix

Pat

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	Confess	Deny
Confess	5, 5	1, 10
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The Circle Trick

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The Circle Trick

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Confess	5, 5	1, 10
Deny	10, 1	2, 2

Chris has a Dominant Strategy:

The “Confess” strategy is best regardless of Pat’s move.

Pat

		Pat	
		Confess	Deny
Chris	Confess	5, 5	1, 10
	Deny	10, 1	2, 2

Checking Pat's Options

Pat

Chris

	Confess	Deny
Confess	5, 5	1, 10
Deny	10, 1	2, 2

Checking Pat's Options

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Checking Pat's Options

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Checking Pat's Options

Pat

Chris

	Confess	Deny
Confess	5, 5	1, 10
Deny	10, 1	2, 2

Pat has a dominant strategy: Confess

Pat

		Confess	Deny
Chris	Confess	5, 5	1, 10
	Deny	10, 1	2, 2



Nash Equilibrium:

Neither side has a desire to switch strategies given what the other is doing.

Pat

		Confess	Deny
Chris	Confess	5, 5	1, 10
	Deny	10, 1	2, 2

Battle of the Sexes

Sarah

John

	Rally	Town Hall
Rally	20, 30	9, 4
Town Hall	10, 16	40, 27

John Analyses the Possibilities

Sarah

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	Rally	Town Hall
Rally	20, 30	9, 4
Town Hall	10, 16	40, 27

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Sarah Analyses the Possibilities

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Town Hall	10, 16	40, 27

Two Nash Equilibria, No Dominant Strategies

Sarah

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Rally	20, 30	9, 4
Town Hall	10, 16	40, 27

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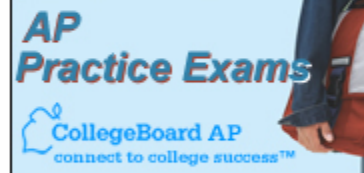
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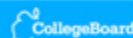


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