# AP MICROECONOMICS – MARKET FAILURE AND THE ROLE OF GOVERNMENT PRACTICE TEST (SAMPLE)

## STUDY GUIDE

## SAMPLE STUDY GUIDE WITH LIMITED QUESTIONS

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# Introduction

Preparing for a certification exam can feel overwhelming, but with the right tools, it becomes an opportunity to build confidence, sharpen your skills, and move one step closer to your goals. At Examzify, we believe that effective exam preparation isn't just about memorization, it's about understanding the material, identifying knowledge gaps, and building the test-taking strategies that lead to success.

This guide was designed to help you do exactly that.

Whether you're preparing for a licensing exam, professional certification, or entry-level qualification, this book offers structured practice to reinforce key concepts. You'll find a wide range of multiple-choice questions, each followed by clear explanations to help you understand not just the right answer, but why it's correct.

The content in this guide is based on real-world exam objectives and aligned with the types of questions and topics commonly found on official tests. It's ideal for learners who want to:

- Practice answering questions under realistic conditions,
- Improve accuracy and speed,
- Review explanations to strengthen weak areas, and
- Approach the exam with greater confidence.

We recommend using this book not as a stand-alone study tool, but alongside other resources like flashcards, textbooks, or hands-on training. For best results, we recommend working through each question, reflecting on the explanation provided, and revisiting the topics that challenge you most.

Remember: successful test preparation isn't about getting every question right the first time, it's about learning from your mistakes and improving over time. Stay focused, trust the process, and know that every page you turn brings you closer to success.

Let's begin.

# How to Use This Guide

This guide is designed to help you study more effectively and approach your exam with confidence. Whether you're reviewing for the first time or doing a final refresh, here's how to get the most out of your Examzify study guide:

### 1. Start with a Diagnostic Review

Skim through the questions to get a sense of what you know and what you need to focus on. Your goal is to identify knowledge gaps early.

### 2. Study in Short, Focused Sessions

Break your study time into manageable blocks (e.g. 30 – 45 minutes). Review a handful of questions, reflect on the explanations.

### 3. Learn from the Explanations

After answering a question, always read the explanation, even if you got it right. It reinforces key points, corrects misunderstandings, and teaches subtle distinctions between similar answers.

### 4. Track Your Progress

Use bookmarks or notes (if reading digitally) to mark difficult questions. Revisit these regularly and track improvements over time.

### 5. Simulate the Real Exam

Once you're comfortable, try taking a full set of questions without pausing. Set a timer and simulate test-day conditions to build confidence and time management skills.

### 6. Repeat and Review

Don't just study once, repetition builds retention. Re-attempt questions after a few days and revisit explanations to reinforce learning. Pair this guide with other Examzify tools like flashcards, and digital practice tests to strengthen your preparation across formats.

There's no single right way to study, but consistent, thoughtful effort always wins. Use this guide flexibly, adapt the tips above to fit your pace and learning style. You've got this!

# Questions

**1. Which policy would typically correct a positive externality in consumption?**

A. A per-unit tax on the good

B. A per-unit subsidy to consumers

C. A government ban on the good

D. A price ceiling on the good

**2. Which statement best describes how externalities are treated in social welfare accounting?**

A. Externalities are ignored in welfare calculations.

B. Externalities are addressed by adjusting government budgets only.

C. Externalities are included by adding their social costs or benefits into the social welfare measure.

D. Externalities do not affect societal welfare.

**3. Which policy would a society aiming for greater income equality most likely adopt?**

A. A progressive income tax and high estate/gift taxes

B. A flat tax with no transfers

C. A regressive tax system and no estate taxes

D. Elimination of inheritance taxes

**4. How can information disclosure policies reduce market failure due to asymmetric information?**

A. Requiring clear labeling and transparent information reduces adverse selection and moral hazard.

B. Withholding information improves competition.

C. Disclosure has no impact on adverse selection.

D. Prices alone fix information problems.

**5. Explain the term 'first-best' policy in the context of externalities.**

A. It ensures SMA and MSC equality with minimal cost.

B. It equals market equilibrium with no externalities.

C. It imposes maximum taxes to achieve social welfare.

D. It exactly matches SMB and MSC with no administrative costs or distortions; often theoretical.

**6. Which of the following is a public good?**

A. A sandwich
B. A haircut
C. National defense
D. An online streaming subscription

**7. What conditions are needed for Coase bargaining to efficiently solve an externality?**

A. Low transaction costs, well-defined property rights, and the ability to bargain.
B. High transaction costs make bargaining infeasible.
C. Property rights must be ignored.
D. Bargaining is never efficient.

**8. In the presence of a negative externality, which curve represents the true social marginal cost?**

A. Social marginal cost (MSC).
B. Private marginal cost (PMC).
C. Average total cost (ATC).
D. Private marginal benefit (PMB).

**9. Subsidizing consumers of education to reach the socially optimal quantity is an example of addressing which type of externality?**

A. Positive externality
B. Negative externality
C. Public good
D. Market failure

**10. Which of the following is an example of a violation of antitrust laws**

A. A firm engaging in aggressive price competition against a rival
B. A firm engaging in price discrimination that varies by customer segment
C. A merger between firms to gain efficiency
D. Engaging in collusive behavior to restrain competition

# Answers

1. B
2. C
3. A
4. A
5. D
6. C
7. A
8. A
9. A
10. D

# Explanations

## 1. Which policy would typically correct a positive externality in consumption?

A. A per-unit tax on the good

B. A per-unit subsidy to consumers

C. A government ban on the good

D. A price ceiling on the good

*A positive externality in consumption means the social benefit from consuming the good exceeds the private benefit to the buyer, so people tend to underconsume relative to the social optimum. A per-unit subsidy to consumers lowers the price they effectively pay and raises the quantity demanded, nudging private marginal benefit up toward the social marginal benefit. This internalizes part of the external benefit and moves the market toward the efficient level of consumption. A per-unit tax would raise the price further and reduce quantity, worsening underconsumption. A government ban eliminates the good altogether, removing both private use and the external benefits. A price ceiling can create shortages or misallocate resources and doesn't directly address the positive externality by boosting social benefits.*

## 2. Which statement best describes how externalities are treated in social welfare accounting?

A. Externalities are ignored in welfare calculations.

B. Externalities are addressed by adjusting government budgets only.

C. Externalities are included by adding their social costs or benefits into the social welfare measure.

D. Externalities do not affect societal welfare.

*Social welfare accounting aims to measure society's overall well being by including all effects that spill over to others, not just those captured in market prices. Externalities are effects of economic activity on third parties that prices do not reflect, so to capture the true impact on welfare they must be added into the social welfare measure as social costs or social benefits. Ignoring them would understate or overstate welfare, and focusing only on government budgets misses broader spillover effects beyond public finances. Externalities do affect societal welfare because they change the total costs and benefits to everyone in society. Therefore, adding the social costs or benefits of externalities into the social welfare measure is the best way to describe their treatment.*

## 3. Which policy would a society aiming for greater income equality most likely adopt?

A. A progressive income tax and high estate/gift taxes

B. A flat tax with no transfers

C. A regressive tax system and no estate taxes

D. Elimination of inheritance taxes

*The main concept here is how tax structure and transfers influence income inequality. A policy that uses a progressive income tax and imposes high estate and gift taxes targets both current income disparities and the concentration of wealth across generations. Progressive taxation taxes higher incomes at higher rates, which reduces after-tax income gaps and funds public transfers and services that support lower- and middle-income households. Estate and gift taxes help limit the lasting accumulation of wealth in the hands of a few, curbing intergenerational transmission of large fortunes that can lock in inequality over time. In contrast, a flat tax with no transfers would be less redistributive, leaving after-tax incomes more unequal. A regressive tax system places a larger burden on lower-income households, widening inequality. Eliminating inheritance taxes removes a mechanism that reduces wealth concentration across generations, allowing inherited wealth to persist and potentially grow.*

## 4. How can information disclosure policies reduce market failure due to asymmetric information?

A. Requiring clear labeling and transparent information reduces adverse selection and moral hazard.

B. Withholding information improves competition.

C. Disclosure has no impact on adverse selection.

D. Prices alone fix information problems.

*Information disclosure policies reduce market failure from asymmetric information by making relevant facts about products, services, and risks visible to everyone. When buyers can't tell quality, markets can be flooded with low-quality goods (the lemons problem). Clear labeling and transparent information let buyers distinguish higher-quality options, leading to better pricing, more informed choices, and trades that reflect true differences in quality. They also help with moral hazard, because when terms, risks, and expected behaviors are disclosed and monitored, parties face clearer incentives and less opportunity to shirk or take excessive risks after a contract is signed. That combination—improved ability to assess quality and aligned incentives—reduces both adverse selection and moral hazard. Withholding information worsens information problems, while relying on prices alone cannot fully fix hidden attributes or incentives.*

## 5. Explain the term 'first-best' policy in the context of externalities.

A. It ensures SMA and MSC equality with minimal cost.

B. It equals market equilibrium with no externalities.

C. It imposes maximum taxes to achieve social welfare.

D. It exactly matches SMB and MSC with no administrative costs or distortions; often theoretical.

*First-best policy means fully internalizing the externality so the outcome is efficient, with the social marginal benefit exactly equal to the social marginal cost. In this ideal situation there are no administrative costs or distortions, so the policy nudges the market to the efficient quantity—often through a tax per unit equal to the external marginal cost or a corresponding quantity restriction. Real-world policies rarely achieve this perfect benchmark because measurement, enforcement, and other distortions introduce gaps, but it serves as the theoretical standard. The other ideas miss this precise alignment or rely on unrealistic assumptions like no intervention or maximally high taxes.*

## 6. Which of the following is a public good?

A. A sandwich

B. A haircut

C. National defense

D. An online streaming subscription

*Public goods are non-excludable and non-rival in consumption. National defense fits this because once security is provided, you cannot realistically bar people from being protected, and one person's protection doesn't reduce the protection available to others. That combination—no easy way to exclude anyone and no depletion of value as more people benefit—defines a public good. A sandwich, a haircut, and an online streaming subscription all fail on one or both of those features. A sandwich is excludable and rival: if you take it, others can't have it, and the seller can prevent access. A haircut is also excludable and rival for the same reason. An online streaming service is excludable (you need a subscription to access), and while viewing may not be easily diminished by one additional viewer, the key point is that access can be restricted, so it's not a non-excludable public good.*

## 7. What conditions are needed for Coase bargaining to efficiently solve an externality?

A. Low transaction costs, well-defined property rights, and the ability to bargain.

B. High transaction costs make bargaining infeasible.

C. Property rights must be ignored.

D. Bargaining is never efficient.

*The idea being tested is that private bargaining can solve externalities when the conditions for bargaining are favorable. Under this view, the efficient outcome emerges when transaction costs are low enough that parties can negotiate without prohibitive expense, and property rights are clearly defined so there is a recognizable entitlement to trade. With such rights, the party who bears or causes the externality can be compensated or required to adjust, and both sides can bargain to the point where the marginal social benefit of the activity equals the marginal social cost. In practice, this means you can reach the efficient level of activity by trading rights or payments, regardless of who initially holds the rights, as long as bargaining is feasible and costs are minimal. If transaction costs are high, bargaining becomes impractical and the private solution fails to be efficient. If property rights aren't clearly defined, there's no straightforward entitlement to trade, so negotiations stall or become paralyzed by dispute. Saying bargaining is never efficient ignores the key insight that efficiency can be achieved privately when these conditions are met.*

## 8. In the presence of a negative externality, which curve represents the true social marginal cost?

A. Social marginal cost (MSC).

B. Private marginal cost (PMC).

C. Average total cost (ATC).

D. Private marginal benefit (PMB).

*When a negative externality exists, producing an extra unit imposes costs on others that the producer doesn't pay. The private marginal cost only reflects the producer's own costs, not these external damages. To capture the total cost to society, you add the external cost per unit to the private cost. That sum is the social marginal cost, which sits above the private marginal cost curve. So the true social marginal cost is represented by the MSC curve. The other curves don't reflect this broader view: average total cost is just average, not the social cost per unit; private marginal benefit is a benefit measure, not a cost; and private marginal cost omits external damages.*

## 9. Subsidizing consumers of education to reach the socially optimal quantity is an example of addressing which type of externality?

A. Positive externality

B. Negative externality

C. Public good

D. Market failure

*Subsidizing consumers of education targets a positive externality. When people choose how much schooling to get, they weigh only their private costs and private benefits. Society, however, gains additional benefits from education—higher productivity, lower crime, better civic participation, and other spillovers that nobody paid for in the market. Because these social benefits aren't reflected in the price, the market tends to underconsume education relative to its true social value. Providing a subsidy lowers the private cost to students, encouraging more education and moving the quantity closer to the socially optimal level. Public goods and market failure are broader concepts, but the specific external effect here is a positive externality created by education.*

**10. Which of the following is an example of a violation of antitrust laws**

A. A firm engaging in aggressive price competition against a rival

B. A firm engaging in price discrimination that varies by customer segment

C. A merger between firms to gain efficiency

D. Engaging in collusive behavior to restrain competition

*Antitrust laws aim to keep markets competitive by prohibiting agreements and practices that restrain trade. A clear violation is when firms collude to restrain competition, such as secretly agreeing on prices, limiting who sells in which markets, or rigging bids. This kind of coordinated behavior removes competition and hurts consumers through higher prices and less choice, so it's illegal under antitrust statutes. In contrast, aggressive price competition is a normal competitive tactic meant to attract customers and gain market share; it isn't illegal by itself. Price discrimination can be legal in many cases, depending on how and why prices differ among customers. Mergers can be permissible if they're unlikely to lessen competition meaningfully and may even bring efficiency, though some mergers are scrutinized or blocked if they threaten competition.*

# Next Steps

Congratulations on reaching the final section of this guide. You've taken a meaningful step toward passing your certification exam and advancing your career.

As you continue preparing, remember that consistent practice, review, and self-reflection are key to success. Make time to revisit difficult topics, simulate exam conditions, and track your progress along the way.

If you need help, have suggestions, or want to share feedback, we'd love to hear from you. Reach out to our team at hello@examzify.com.

Or visit your dedicated course page for more study tools and resources:

https://apmicro.examzify.com

We wish you the very best on your exam journey. You've got this!