Review questions for EC 201, Exam #2 Fall 2015

This is a list of questions to help you prepare for exam #2.

Two of the questions on exam #2 will come from the list of review question for exam #1 (but they will not repeat any of the questions on exam #1).

You will answer all questions on the exam. Bring a pen or pencil (colored pencils & pens may be helpful) and a ruler to the exam.

You may not use any electronic devices during the exam.

Chapter 5:

Facts and tools:

5. Let’s work on a few examples to get a sense of what elasticity of demand means in practice. Remember that in all of these cases, we’re moving along a fixed demand curve—so think of supply increasing in demand or decreasing, while the demand curve is staying in the same place.

a. If the elasticity of demand for college textbooks is -0.1 and the price of textbooks increases by 20% how much will the quantity demand change and in what direction?

b. In your answer to part a, was your answer in percentage or in total textbooks?

c. If the elasticity of demand for spring break packages to Cancun is -5, and if you notice that this year in Cancun the quantity of packages demanded is increased by 10% then what happened to the price of Cancun vacation prices?

d. In your college town, real estate developers are building thousands of new student-friendly apartments close to campus. If you want to pay the lowest rate possible, should you hope the demand for the apartments is elastic or inelastic?

e. In your college town, the local government decrees that thousands of apartments close to campus are uninhabitable and must be torn down next semester. If you want to pay the lowest rent possible, should you hope that demand for apartments is elastic or inelastic?

f. If the elasticity of demand for ballpoint pens with blue ink is at -20, and the price of ball point pens with blue ink rise by 1%, what happens to the quantity demanded?

7. Read the question information in the book and look at the table to answer these questions…

a. Based on these demand elasticity estimates, which fruit is most inelastically demanded? Which is most elastically demanded?

b. For which of these fruits would 10%drop in price cause an increase in total revenue from the sale of that fruit?

c. If the government could only offer “10% off” coupons for three of these fruits, and it wanted to have the biggest possible effect on quantity demanded, which three fruits should get the coupon?

d. Overall, the authors found that for the average fruit, the elasticity of demand was about -0.5. Is the demand for fruit elastic or inelastic?

g. What’s an obvious substitute for ball point blue ink pens? (This explains why the demand is so elastic…)

Thanking and Problem Solving:

3. Henry Ford famously mass-produced cars at the beginning of the 20th century, starting Ford Motor Company. He made millions because mass production made cars cheap to make, and he passes some of the savings to the consumer in the form of the savings to the consumer in the form of a low price. Cars became a common sight in the U.S. thereafter. Keeping total revenue and its relationship with price in mind, do you expect the demand for cars to be elastic or inelastic given the story of Henry Ford.

9. The table for this problem is on page 87… Let’s practice the midpoint formula. Calculate the elasticity of demand for each of the following goods or services…

Chapter 6:

Facts & Tools

2. Junk food has recently been criticized for being unhealthy and too cheap, enticing the poor to adopt unhealthy lifestyles. Suppose that the state of Oklakansas imposes a tax on junk food.

a. What needs to be true for the tax to actually deter people from eating junk food: Should junk food demand be elastic or should it be inelastic?

b. If the Oklakansas government wants to strongly discourage people from eating junk food, when will it need to set a higher tax rate: when the JFD is elastic or inelastic?

c. But hold on a moment… The supply side matters as well. If junk food supply is highly elastic—perhaps it’s not that hard to start selling salads with low-fat dressing instead of mayo and cheese laden burgers—does that mean that junk food tax will have a bigger effect than if supply were inelastic? Or is it the other way aroud?

Thinking & Problem Solving

2. Let’s see if we can formulate

Challenges

1.

Chapter 7:

Facts & Tools:

5.

Thinking & Problem Solving

2.

Challenges:

1.

Chapter 8:

Facts and Tools:

3.

12.

Thinking and Problem Solving:

5.

Additional questions:

1. The demand and supply of fast food workers is listed in the table below. Use that information to draw the demand and supply curves (graph paper will make this easier). If the wage is $9/hour, what is the quantity supplied? Quantity demanded? What is the equilibrium quantity? Calculate the area of consumer surplus. Calculate the area of producer surplus. Suppose a minimum wage law sets the wage at $13/hour. What is the quantity supplied? Quantity demanded? What is the equilibrium quantity? Calculate the area of consumer surplus. Calculate the area of producer surplus. Calculate the area of deadweight loss.

Price Quantity demanded Quantity supplied

17 0 80

15 10 70

13 20 60

11 30 50

9 40 40

7 50 30

5 60 20

3 70 10

1 80 0

0 85 0

1. Draw a demand schedule for Slurpees and identify the four points in the table below.

|  |  |
| --- | --- |
| Price | Quantity Demanded |
| $3 | 50 |
| $2 | 100 |
| $1 | 125 |
| $0.50 | 150 |

Calculate the price elasticity of demand when price falls from $3 to $2.

Calculate the price elasticity of demand when price falls from $1 to $0.50.

Calculate total revenue at each of the four points on the demand curve.

Draw the total revenue schedule and identify the range on the total revenue schedule where the demand elasticity is said to be “elastic” and where it is said to be “inelastic.”

If you are a seller of Slurpees and you want to increase your price and your total revenue, along what part of demand curve must you be?

1. The price of bacon rises 15% and the quantity demanded of eggs falls 7.5%. What is the cross-price elasticity of demand? What is the relationship between the two products?
2. During a recession household and individual incomes tend to fall. During a recession what is likely to happen to the consumption of tickets to the movies? The consumption of movie rentals? What kind of a good is the former? The latter?
3. Assume that if minimum wages laws were no longer used in the labor market for fast food, the equilibrium wage would be $6.50/hour. Why would it be unlikely that fast food restaurants would be successful in conspiring to drive hourly wages below the equilibrium wage?
4. You are told that the demand curve for smart phones is P=500-(1/2)Q and the supply curve is P=100+(3/4)Q. Draw the demand and supply curves and identify the intercepts points. Use the equations to calculate the equilibrium price and quantity. Then calculate the area of consumer surplus and the area of producer surplus.