CLAS Econ 1 Review Sheet 4

Opening Questions:

1. What might cause a government to interfere with the market equilibrium of a good?

2. How might the incidence of a tax be affected by the relative elasticities of supply and demand?

3. If Supply and Demand both have the same elasticity, do buyers share a higher burden of a sales tax at the point of purchase on buyers?

Important Definitions (Try to define for yourself first):

- Tax vs Subsidy =
- Shortage vs Surplus =
- Price Floor vs Price Ceiling =
- Quota vs Mandate =

Relate to Today

- In California, grape production is a large section of the agricultural sector, especially because of the wine production market. Suppose there is a food shortage going on, particularly in relation to crops. What might the government do to solve the issue?

Practice Problems

1.

1. A tax on buyers causes which of the following?
(i) a leftward shift of the demand curve
(ii) a decrease in quantity sold
(iii) an increase in the price buyers pay

a. (i), (ii), and (iii)
b. (i) and (iii)
c. (ii) and (iii)
d. only (i)
e. None of the answers

2. What would the split of a $10 per unit tax on cheese blocks look like if Supply is relatively more elastic than Demand?

a. Buyers pay the entire tax
b. Sellers pay the entire tax
c. Buyers pay more of the tax
d. Sellers pay more of the tax

3. What would the split of a $10 per unit tax on hot chocolate look like if Supply is relatively less elastic than Demand?

a. Buyers pay the entire tax
b. Sellers pay the entire tax
c. Buyers pay more of the tax
d. Sellers pay more of the tax

4. What would the split of a $10 per unit tax on hydroflasks look like if Supply is perfectly inelastic?

a. Buyers pay the entire tax
b. Sellers pay the entire tax
c. Buyers pay more of the tax
d. Sellers pay more of the tax

5. What would the split of a $10 per unit tax on pizzas look like if Supply is perfectly elastic?

a. Buyers pay the entire tax
b. Sellers pay the entire tax
c. Buyers pay more of the tax
d. Sellers pay more of the tax

6. A binding price floor is placed on the market for sardines. What is the result in the market? (circle all correct answers)

a. There is no change to the original market equilibrium
b. The new market price is lower than in equilibrium
c. The new market price is higher than in equilibrium
d. There is a shortage of sardines in the market
e. There is a surplus of sardines in the market

7. A binding price ceiling is placed on the market for shrimp. What is the result in the market? (circle all correct answers)

a. There is no change to the original market equilibrium
b. The new market price is lower than in equilibrium
c. The new market price is higher than in equilibrium
d. There is a shortage of shrimp in the market
e. There is a surplus of shrimp in the market

8.

If demand is _____, a higher price yields _____ total revenue.

a. inelastic; lower
b. inelastic; no change in
c. elastic; higher
d. elastic; lower
e. none of the answers

9.

Do you think the price elasticity of demand for Ford sport-utility vehicles (SUVs) will increase, decrease, or remain the same when each of the following events occurs? Explain your answer.

a. Other car manufacturers, such as General Motors, decide to make and sell SUVs
b. SUVs produced in foreign countries are banned from the American market.
c. Due to ad campaigns, Americans believe that SUVs are much safer than ordinary passenger cars.

10.

Consider the widget industry. Suppose income increases, and as a consequence, Q widget remains unchanged while P Widget increases.. Which of the following is a possible explanation for why this happened?

a) Widgets are inferior and supply is perfectly elastic.

b) Widgets are inferior and supply is perfectly inelastic.

c) Widgets are inferior and demand is perfectly elastic.

d) Widgets are normal and supply is perfectly elastic.

e) Widgets are normal and supply is perfectly inelastic.

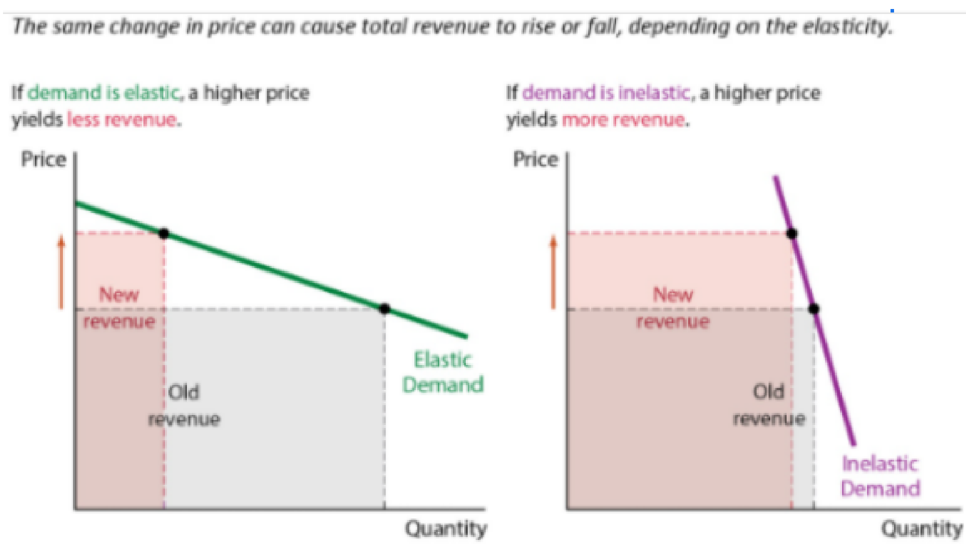
Answers

Important Definitions (Try to define for yourself first):

- Tax vs Subsidy = A tax is a government intervention to the established equilibrium of the market, collecting a specified amount as government revenue. On the opposite side, a subsidy is a government intervention to the established equilibrium of the market, usually to incentivize the supply of a specific good.
- Shortage vs Surplus = A shortage occurs when quantity demanded is higher than the quantity supplied at a given price level. A surplus occurs when quantity demanded is lower than quantity supplied at a given price level. Both can happen with interventions to a previously established market equilibrium.
- Price Floor vs Price Ceiling = A binding price floor is a fixed price above the equilibrium which elicits new quantity responses. A binding price ceiling is a fixed price below the equilibrium which elicits new quantity responses.
- Quota vs Mandate = A quota is a fixed quantity which restricts quantity below the equilibrium. A mandate is a fixed quantity which forces the quantity above the equilibrium.

1. A
2. C
3. D
4. B
5. A
6. C, E
7. B, D

8.



D. Elastic; Lower

-If demand is more elastic, an increase in price will decrease total revenue
-If demand is more inelastic, an increase in price will increase total revenue
-If buyers are more responsive to changes in price(elastic demand), less units will be bought if you increase price compared to inelastic demand

9.

A. Price Elasticity of Demand would increase (more options)
B. Price Elasticity of Demand would decrease (less options)
C. Price Elasticity of Demand would decrease (more reason to stick to SUVs)

10. Answer Option E (Widgets are normal and supply is perfectly inelastic) is correct.