#1 If the price Px and Py increase 10% at the same time, with income Remaining unchanged, show that this is equivalent to a reduction in income.

#2 Demonstrate how PCC with varying price Py, (Px and Income are fixed) can give us the price elasticity of Y to be equal to, less than, or greater than 1 in absolute value

7. A college student has two options for meals: eating at the dining hall for $6 per meal, or eating a Cup O' Soup for $1.50 per meal. Her weekly food budget is $60.

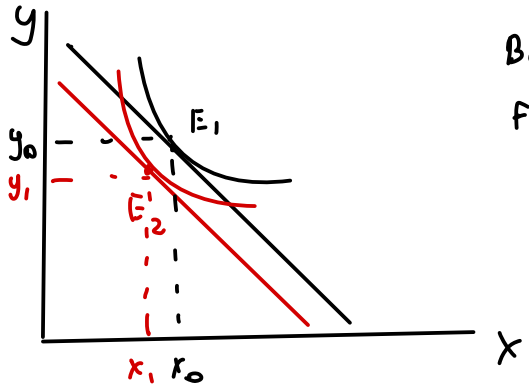
   a. Draw the budget constraint showing the trade-off between dining-hall meals and Cups O' Soup. Assuming that she spends equal amounts on both goods, draw an indifference curve showing the optimum choice. Label the optimum as point A.

   b. Suppose the price of a Cup O' Soup now rises to $2. Using your diagram from part (a), show the consequences of this change in price. Assume that our student now spends only 30 percent of her income on dining-hall meals. Label the new optimum as point B.

   c. What happened to the quantity of Cups O' Soup consumed as a result of this price change? What does this result say about the income and substitution effects? Explain.

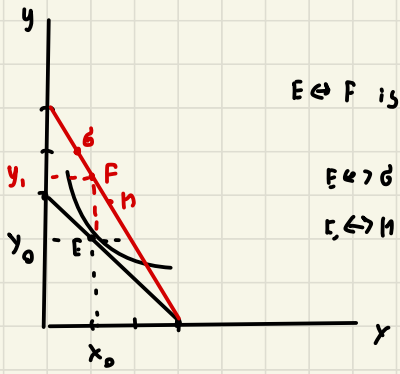
   d. Use points A and B to draw a demand curve for Cup O' Soup. What is this type of good called?

1)



Budget Line will shift down from E_1 to E_2

c)



E ⇔ F is $|\eta_y| = 1$

E ⇔ G is elastic $|\eta_y| > 1$

E ⇔ H is inelastic $|\eta_y| < 1$

Remaining unchanged, show that this is equivalent to a reduction in income.

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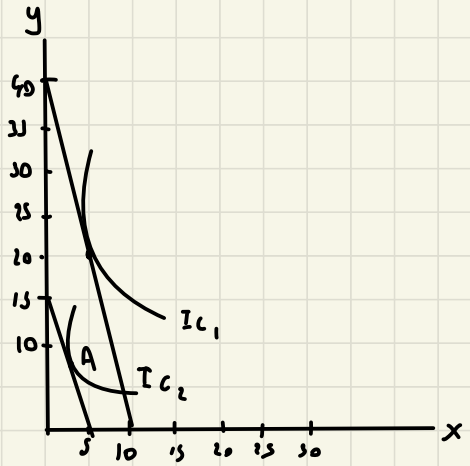
a)

x = dining hall
y = Cup O' Soup

$P_x = \$6$
$P_y = \$1.5$
Budget = $\$60$

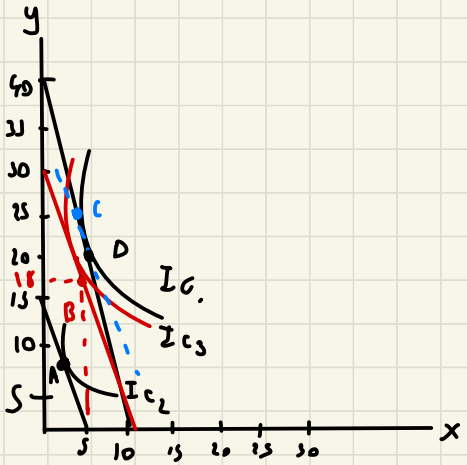
Budget Line = $6x + 1.5y = 60$



b) $P_x = \$6$
$P_y = \$2$
Budget = $\$60$

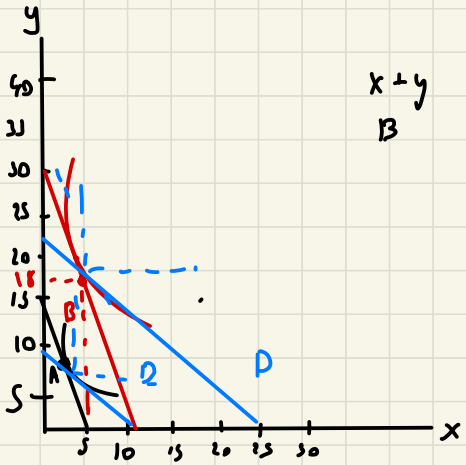
Budget Line $6x + 2y = 60$

b)



c) Price change effect quantity of y decrease because increase in price of p_y with same amount of Budget Line Substitution Effect is more of y and less of x from D to C

D)



x + y are normal good on point A and B