

HW#5 Due September 22, 2020

Mankiw Page 107

3. Suppose the price elasticity of demand for heating oil is 0.2 in the short run and 0.7 in the long run.

$+\$0.40$

a. If the price of heating oil rises from \$1.80 to \$2.20 per gallon, what happens to the quantity of heating oil demanded in the short run? In the long run? (Use the midpoint method in your calculations.)

b. Why might this elasticity depend on the time horizon?

7. Suppose that your demand schedule for pizza is as follows:

Price	Quantity Demanded (income = \$20,000)	Quantity Demanded (income = \$24,000)
\$8	40 pizzas	50 pizzas
10	32	45
12	24	30
14	16	20
16	8	12

a. Use the midpoint method to calculate your price elasticity of demand as the price of pizza increases from \$8 to \$10 if (i) your income is \$20,000 and (ii) your income is \$24,000.

b. Calculate your income elasticity of demand as your income increases from \$20,000 to \$24,000 if (i) the price is \$12 and (ii) the price is \$16.

$$a) \frac{\frac{\Delta Q}{Q}}{\frac{\Delta P}{P}} = \frac{\Delta Q}{Q} \div \frac{\Delta P}{P} \quad \% \Delta Q_D = \frac{(0.2)(0.40)}{2} \times 100 \quad \left. \begin{array}{l} \\ \end{array} \right\} \text{short run}$$

$$= 4\%$$

$$\frac{\% \Delta P}{2} = \frac{2.20 - 1.80}{2} \times 100 \quad \% \Delta Q_D = \frac{(0.7)(0.40)}{2} \times 100 \quad \left. \begin{array}{l} \\ \end{array} \right\} \text{long run}$$

$$= 14\%$$

b) This elasticity depends on time horizon because of the alternative energy options that might be available in the future. This might decrease the quantity demanded for heating oil since consumers prefer the other options.

$$7. a) \text{ Midpoint formula, } : \frac{1}{\text{slope}} \cdot \frac{P_0 + P_1}{Q_0 + Q_1}$$

$$= \frac{1}{-1/4} \cdot \frac{1}{4}$$

Price elasticity of demand = -1
when income is \$20k

$$\frac{1}{\text{slope}} \cdot \frac{P_0 + P_1}{Q_0 + Q_1}$$

$$= \frac{1}{-2/5} \cdot \frac{18}{95}$$

Price elasticity of demand = -0.47
when income is \$24k

$$b) \text{ Income elasticity of demand : } \frac{\% \Delta Q}{\% \Delta I} = \frac{(Q_1 - Q_0)/Q_0}{(I_1 - I_0)/I_0}$$

$$= \frac{(30 - 24)/24}{(24k - 20k)/20k} = \frac{25\%}{20\%}$$

when the price is \$12

$$= 1.25$$

$$\frac{\% \Delta Q}{\% \Delta I} = \frac{(Q_1 - Q_0)/Q_0}{(I_1 - I_0)/I_0}$$

$$= \frac{(12 - 8)/8}{(24k - 20k)/20k} = \frac{50\%}{20\%}$$

when the price is \$16

$$= 2.5$$