

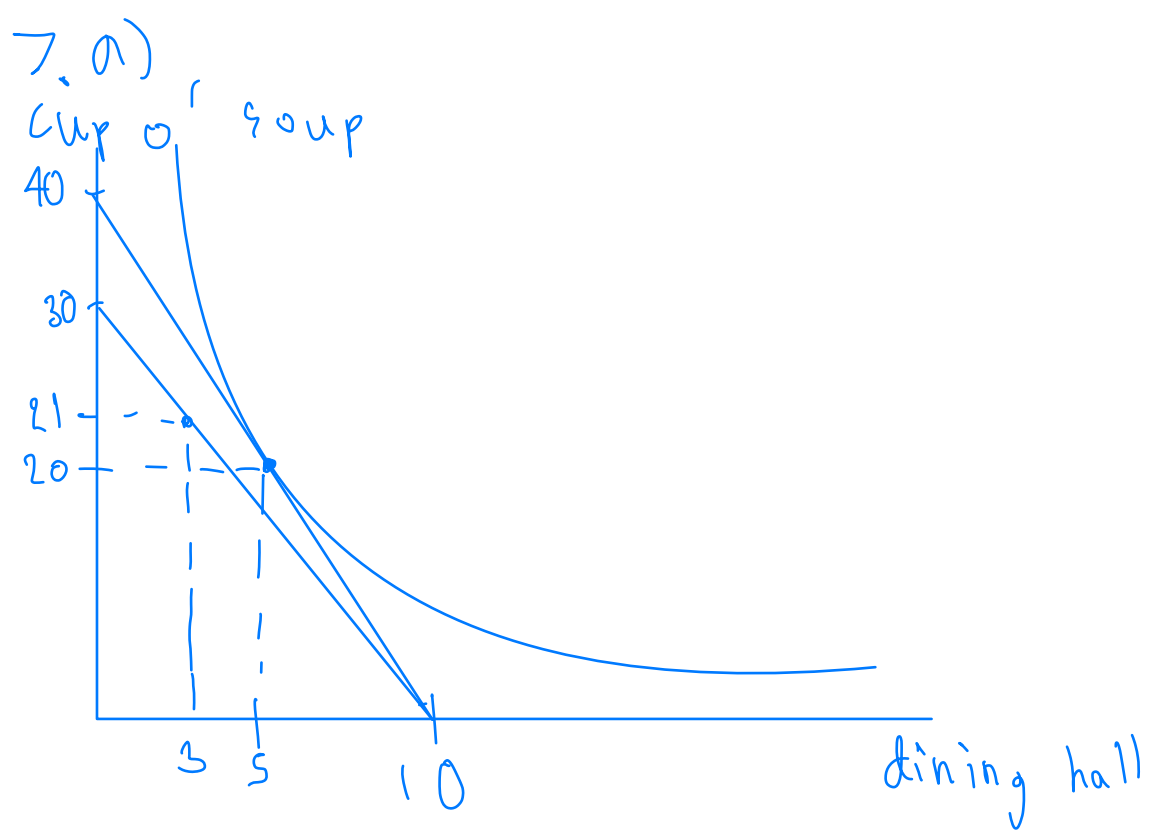
#1 Demonstrate how PCC with varying price  $P_y$ , ( $P_x$  and Income are fixed) can give us the price elasticity of  $Y$  to be equal to, less than, or greater than 1 in absolute value

#2

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

#3

11. Economist George Stigler once wrote that, according to consumer theory, "if consumers do not buy less of a commodity when their incomes rise, they will surely buy less when the price of the commodity rises." Explain this statement using the concepts of income and substitution effects.



$$2 \quad 6X + 1.5Y \leq 60$$

$$1 \quad \frac{6X + 1.5Y \leq 60}{1.5}$$

$$2 \quad 4X + Y \leq 40$$

Assuming that she spend equal amounts on both goods.

$$6X = \frac{60}{2}$$

$$X = 5$$

$$1.5Y = \frac{60}{2}$$

$$Y = 20$$

7) b.

Suppose the price of a Cup O' Soup now rises to \$2.

$$6x + 2y \leq 60$$

$$3x + y \leq 30$$

spend only 30% of her income  
on dining hall meal

$$6x = 60 \times \frac{30}{100}$$

$$x = 3$$

$$2y = 60 \times \frac{70}{100}$$

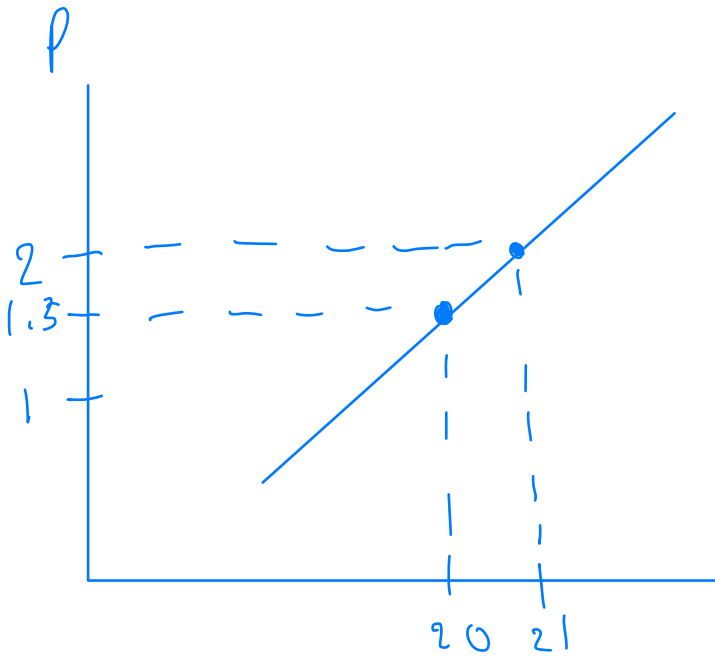
$$y = 21$$

7.C)

- 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.

quantity of cups O' soup consumed  
increased by 1  
the result of substitution effect  
decrease the consumption but  
income effect increase consumption

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



Cups O' soup

demand curve has positive slope = Cup O' soup is giffen good

11. Economist George Stigler once wrote that, according to consumer theory, "if consumers do not buy less of a commodity when their incomes rise, they will surely buy less when the price of the commodity rises." Explain this statement using the concepts of income and substitution effects.

if consumers do not buy less of a commodity when their incomes rise this means the good is a normal good. a change in price makes consumers buy less of the good because of the substitution effect. The good looks more expensive.

Increasing in price makes consumers have less ability to buy.

Substitution and Income effects for a price rise make consumers buy less.