

Poom 6304641183

#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.
 - 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?

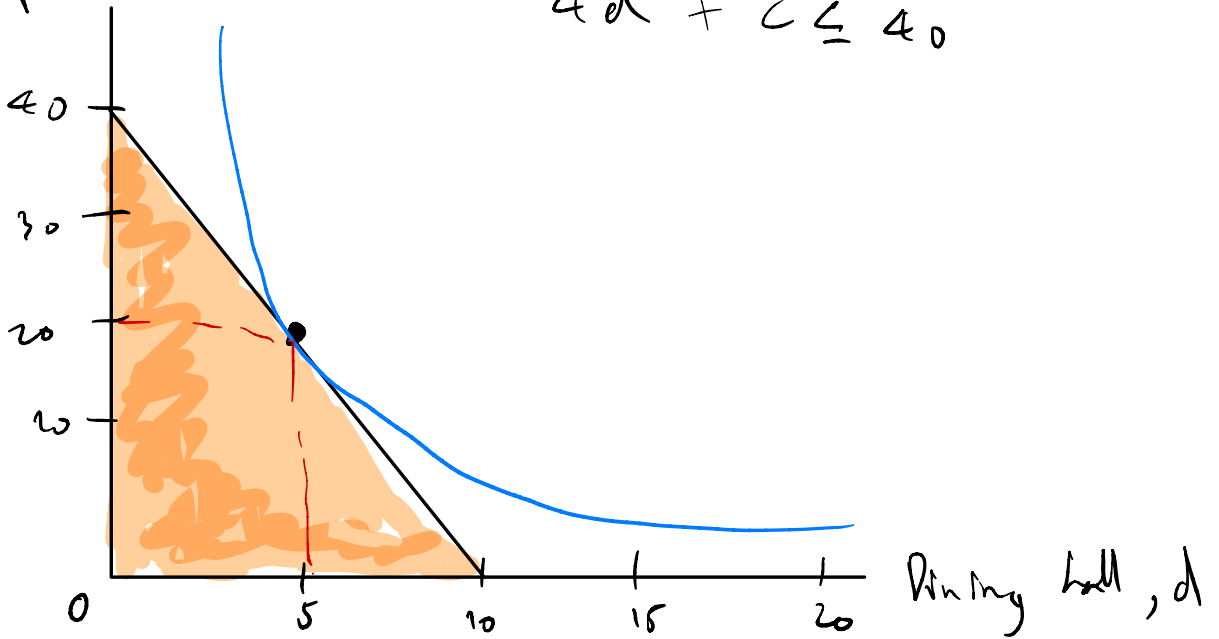
#3

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 (a.) $6d + 1.5c \leq 60$

Cup of soup, c

$4d + c \leq 40$

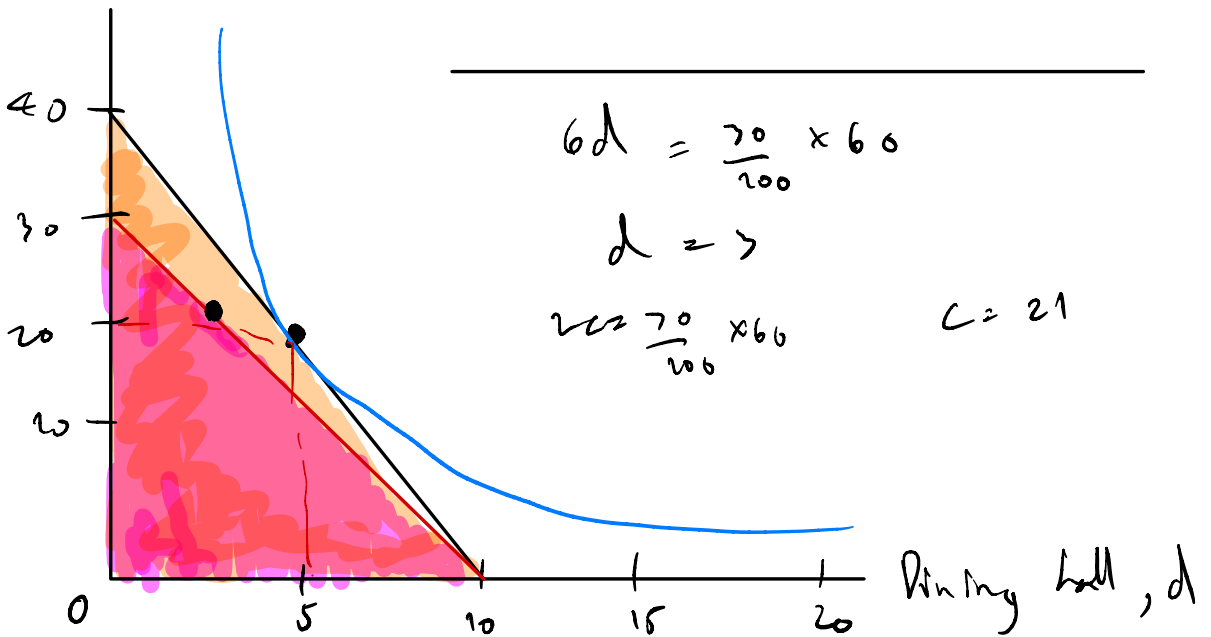


(b.)

$6d + 2c \leq 60$

Cup of soup, c

$7d + c \leq 70$



$6d = \frac{70}{200} \times 60$

$d = 7$

$2c = \frac{70}{200} \times 60$

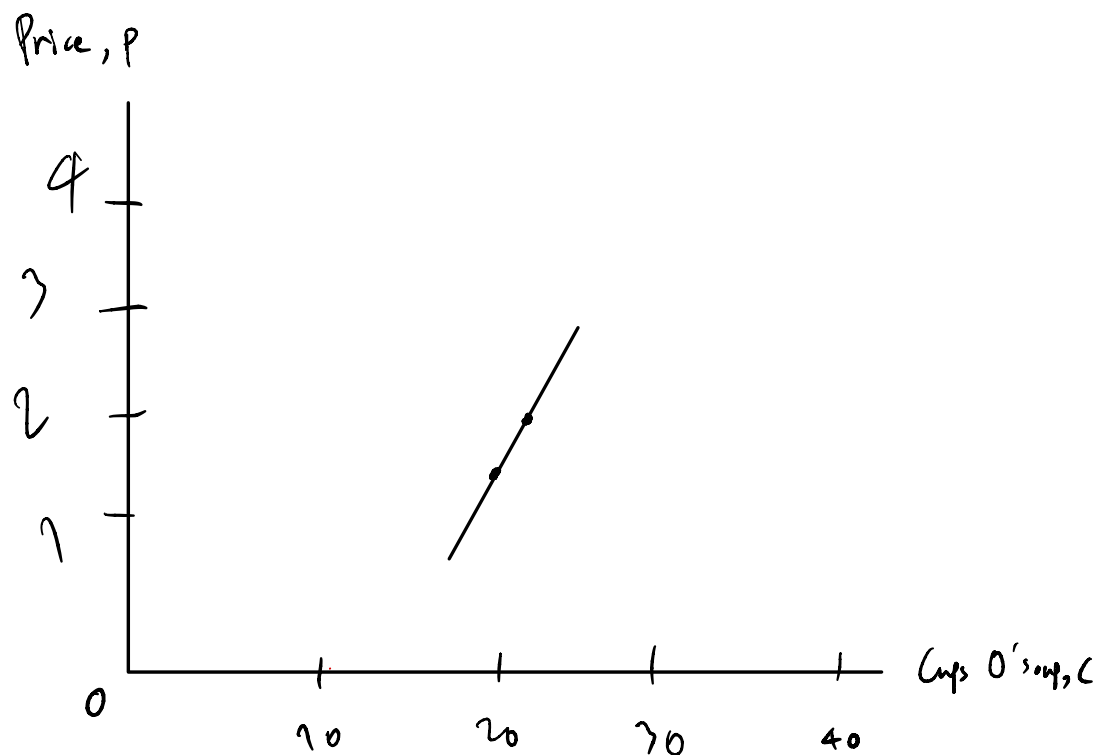
$c = 21$

(c.) As a result of price change, consumption of meals at Cups O'soup increased by 1

As a result of substitution effect, consumption should have decreased,

∴ As the consumption has increased this means that income effect must have resulted into increase in its consumption (Meal at Cups O'soup is inferior good as the fall in real income has resulted into increase in its consumption) and outweighed the substitution effect.

(d.)



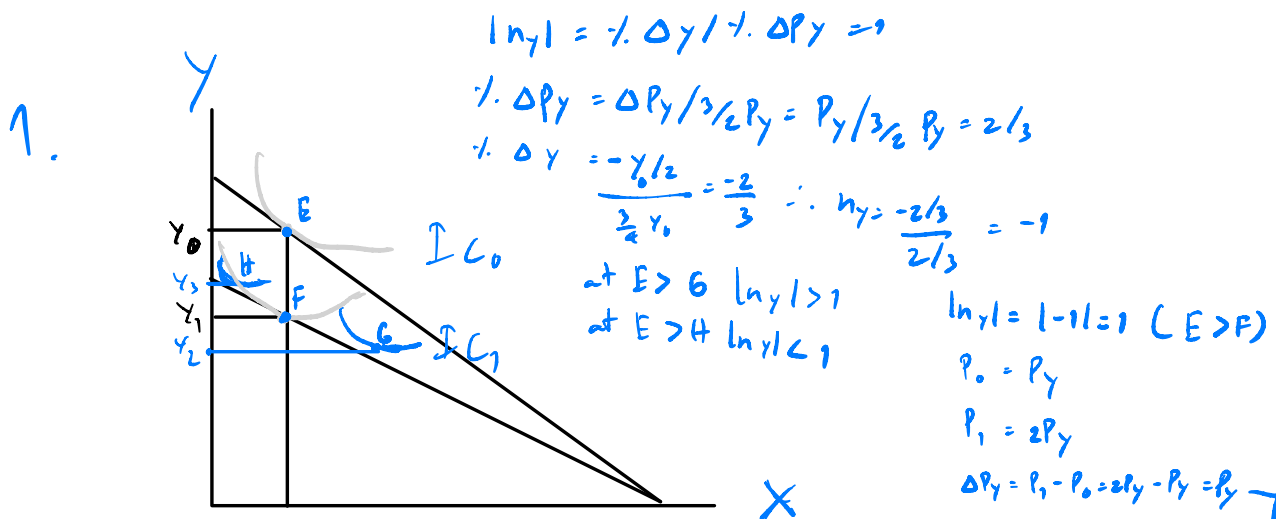
Positive slope \Rightarrow Giffen good.

3. The goods might be considered as normal goods.

The goods look more expensive, the consumers buy less because of substitution effect.

The rise in prices also makes the consumers has less power to buy and accordingly purchases less of goods

So substitution effect and income effect for price rises affect the consumer to buy less.



$$\frac{P_1 + P_0}{2} = \frac{3P_y}{2} = \frac{3}{2} P_y$$

$$Y_1 = \frac{Y_0}{2}, Y_0 \quad \Delta y = Y_1 - Y_0 = \frac{Y_0}{2} - Y_0 = -\frac{Y_0}{2}$$

$$\frac{Y_1 + Y_0}{2} = \frac{\frac{Y_0}{2} + Y_0}{2} = \frac{3}{4} Y_0$$