

HW#5 Due February 25, 2021

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.
- 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.)
 - 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

- 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.
- 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.

3. A. $P_1 = \$1.80$
 $P_2 = \$2.20$

Short-run :

$$\eta_D = 0.2$$

$$0.2 = \frac{\% \Delta Q_D}{\Delta P / \bar{P}}$$

$$\% \Delta Q_D = \frac{0.2(0.4)}{2}$$

$$= 0.04$$

Long-run : $\eta_D = 0.7$

$$0.7 = \frac{\% \Delta Q_D}{\Delta P / \bar{P}}$$

$$\frac{0.7(\Delta P)}{\bar{P}} = \% \Delta Q_D$$

$$\% \Delta Q_D = \frac{0.7(0.4)}{2}$$

$$= 0.14$$

Answer : When the price of heating oil increases, the Q_D decreases for short-run 4% and for long-run 14%.

3 B.

Elasticity depends on the time horizontal because price of elasticity of demand is depends on availability of substitution. consumer will find substitution goods that could be even better than the heating oil if they have more time.

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7. A. (i)

$$P_1 = \$8 \quad Q_1 = 40$$

$$P_2 = \$10 \quad Q_2 = 32$$

$$\begin{aligned} \eta_D &= \frac{1}{\text{slope}} \cdot \frac{\bar{P}}{\bar{Q}} \\ &= \frac{Q_2 - Q_1}{P_2 - P_1} \cdot \frac{(P_1 + P_2)/2}{(Q_1 + Q_2)/2} \\ &= \frac{-8}{2} \cdot \frac{18}{72} \end{aligned}$$

$$= -1$$

$$(ii) Q_1 = 50$$

$$Q_2 = 45$$

$$\eta_D = \frac{-5}{2} \times \frac{18}{95} = -\frac{9}{19} = -0.47$$

B. (i)

$$I = 20,000 \quad Q_D = 24$$

$$I = 24,000 \quad Q_D = 30$$

$$\eta_I = \frac{\% \Delta Q_D}{\% \Delta I} = \frac{1/4}{1/5} = \frac{5}{4} = 1.25$$

(ii)

$$I = 20,000 \quad Q_D = 8$$

$$I = 24,000 \quad Q_D = 12$$

$$\eta_I = \frac{1/2}{1/5} = \frac{5}{2} = 2.5$$