

Economics 101: Problem Set #2

1. Define "normal good" and "inferior good." Describe two goods which are normal for you and two goods you consider to be inferior. Explain why you classified these goods accordingly. If your current income doubles, how will your consumption of these goods change?

2. (a) Which is greater: your total utility from two slices of pizza or from four slices of pizza? Why?

 (b) Which is greater: your marginal utility of the second slice of pizza or your marginal utility of the fourth slice? Why?

3. Suzi Q spends all her income on used books and bagels. Draw her budget line where:
 - (a) her income is \$60, the cost of a used book is \$1 and the cost of a bagel is \$2;
 - (b) her income is \$90 and the prices stay constant;
 - (c) her income is \$60 and the price of used books rises to \$2 and the price of bagels rises to \$4;
 - (d) her income is \$60 and the price of used books rises to \$4, price of bagels is \$2 as in part (a).

4. Explain the meaning of the slope of the indifference curve.

5.

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|---|------|---|---|---|---|---|---|---|---|---|
| P | \$10 | 9 | 8 | 7 | 6 | 5 | 4 | 3 | 2 | 1 |
| Q | 0 | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |

An individual's demand schedule for "Beefy" T-shirts is given above. Suppose there are 10 people in the market, and each has the same demand schedule.

- a) Find the demand schedule for the market.

- b) Draw an individual's demand curve and the market demand curve. (see above)

- c) Calculate the elasticity of demand for an individual demand curve and the market curve when price increases from \$5 to \$6.

- d) "Beefy" is just one among several brands of T-shirts in the market. Is the demand for "Beefy" more or less elastic than the demand for all brands taken together.?

- e) Assume you are not a fussy consumer and do not care what brand of T-shirt you wear. What does this say about your elasticity of demand for "Beefy" T-shirts?

6. Suppose you are part of a management team that is considering a change in the price your firm charges for its compact discs. One member of the team believes the price elasticity of demand for compact discs is 0.5, another member believes it is 1.5 and a third argues it is 1.0. Does it matter which is correct? If so, why?

7. In each of the following pairs of items, select the one that would have the more elastic demand. Indicate whether the main determinant of elasticity is:

(i) the degree of substitutability;

(ii) the portion of buyer's income devoted to expenditure on the good;

(iii) the length of time over which demand conditions are considered.

| | <i>More Elastic</i> | <i>Determinant</i> <i>(i/ii/iii)</i> |
|--|---------------------|---|
| meat or beef | | |
| demand for gasoline this week or demand for gasoline this year | | |
| toothpaste or shoes | | |
| salt or butter | | |