

Problem Set #2, Due Tues., Feb. 25

General Instructions: Hand in your answers on separate pieces of paper (**but stapled together**). Answer all questions clearly, completely and concisely and make clear which answers are to which parts of the questions. **Print legibly.** You may use graph paper but that is not required.

1. The Market for Silly Puddy.
 - a. Draw the market for silly puddy, assuming the market is perfectly competitive and the Supply and Demand Curves are neither perfectly elastic nor perfectly inelastic. Clearly label everything, including the Equilibrium Price at \$4.50 per bucket of silly puddy and the Equilibrium Quantity at 25 million buckets of silly puddy sold annually.
 - b. President Bush believes that, since silly puddy builds moral character, silly puddy should be affordable to all. In order to make silly puddy affordable, the President issues an Executive Order mandating that no one may sell silly puddy for more than \$3 per bucket. On your graph of the silly puddy market, clearly depict the effects of this policy. Will Americans consume less than, more than or exactly 25 million buckets of silly puddy per year after this Executive Order goes into effect?
2. The Market for Aluminum Foil.
 - a. Draw a graph of the market for aluminum foil, assuming that this market is perfectly competitive. Clearly label everything.
 - b. Indicate the Consumer Surplus and Producer Surplus in this market.
 - c. On a separate graph, indicate the effects of a tax on the production of aluminum foil.
 - d. Clearly label the Deadweight Loss from this tax and the amount of tax revenue collected.
3. Suppose that you have \$50 to spend on snacks for your family for the month. Sadly, the only snack food products available for sale in your isolated town are Honey Roasted Soy Nuts and Bananas. The Soy Nuts cost \$4 per bag and the bananas cost 50 cents per pound.
 - a. Draw a Budget Constraint for snack foods for the month. Clearly label the axes and indicate where the Budget constraint hits the axes. (Place pounds of Bananas on the horizontal axis and bags of Soy Nuts on the vertical axis.)
 - b. Draw typical Indifference Curves for Soy Nuts and Bananas and indicate what combination of the 2 goods a utility-maximizing consumer would choose.
 - c. Suppose that due to a heated trade war with The Banana Republic (the Republic, not the clothing store), the price of bananas jumps to \$1 per pound. Graphically illustrate how this will affect your choice between Soy Nuts and Bananas.

d. Briefly explain how the change in the price of bananas affects your choices of both goods in terms of Income Effects and Substitution Effects.

4. Sally collects sea shells from 3 different beaches. Her goal is to collect as many sea shells as possible in whatever free time she has available to make some money when Sally sells sea shells by the sea shore. Sally figures that she can collect sea shells from each beach according to the following table. (She can only spend whole hours at each beach, i.e. no splitting an hour between 2 beaches or among all 3.)

<u>Hours Collecting</u>	<u>Mac Beach</u>	<u>Al Beach</u>	<u>Lester Beach</u>
0	0	0	0
1	10	13	15
2	18	24	28
3	24	34	39
4	28	42	49
5	28	42	57

- If Sally has only 1 hour to spend collecting sea shells, which beach should she spend it at?
- If Sally has 3 hours to spend, how should she allot her time among the 3 beaches?
- If Sally has 5 hours, how should she allot her time?
- If Sally has 8 hours, how should she allot her time?
- In order for Sally to optimize her shell-collecting time, what must be true of the last hour Sally spends collecting shells on each beach?

5. What is a “Giffen Good?” Be specific.

6. Use a diagram to indicate the Deadweight Loss (DWL) from a “Land Tax” (as argued by Henry George and others). How are elasticity and DWL related? Briefly explain.

7. Are Labor Supply Curves always upward-sloping? Explain with reference to Income and Substitution Effects.

8. A tariff of 24% was recently enacted on most categories of lumber from Canada. Who benefits from this tariff? Who is hurt? Use a diagram to explain your answers.

Bonus:

1. According to the Economist Intelligence Unit, which city has the highest “Cost of Living?” (2 pts)

2. According to Transparency International, which is the least corrupt national government in the world? (2 pts)