

Please answer the questions on this sheet, in the space provided

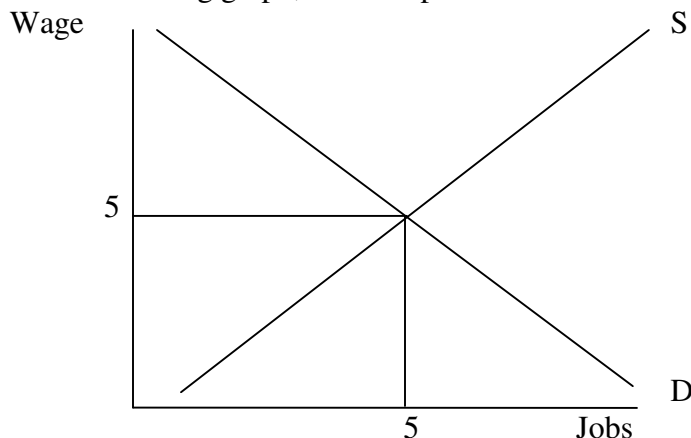
1.) When the price of a good rises from \$3 to \$5, the quantity demanded falls from eight to two. Calculate the price elasticity of demand using:

- a.) the class method _____
- b.) the midpoint method _____

2.) The price elasticity of demand for some good was calculated to be .26. This means:

- a.) a 1% increase in price will lead to a _____% decrease in quantity demanded.
- b.) a 7% increase in price will lead to a _____% decrease in quantity demanded.
- c.) a price elasticity of demand of .26 means the good is elastic/inelastic. (choose one)

3.) Consider the following graph, which represents a labor market:



- a.) What is the equilibrium wage in this market? _____
- b.) What is the equilibrium number of jobs in this market? _____
- c.) Explain what effect a minimum wage of \$4.00 would have in this market on the prevailing wage and number of jobs.
- d.) Explain what effect a minimum wage of \$6.00 would have in this market on the prevailing wage and number of jobs.
- e.) What type of price control is a minimum wage? _____

4.) Two politicians, Demos and Respub, are arguing about whether or not increasing the minimum wage would be good policy. Respub says, "If we increase the minimum wage, the total number of jobs in the economy will fall." Put yourself in the place of Demos, and provide a counter argument, using the tools of supply and demand, that says under what conditions the total number of jobs will not fall when a minimum wage is imposed.

Now, put yourself in the shoes of Respub. Can you provide a counter argument to the counter argument you just gave as Demos? (Hint: we discussed in class how some workers may lose their job, even if the total number of jobs does not decrease.)

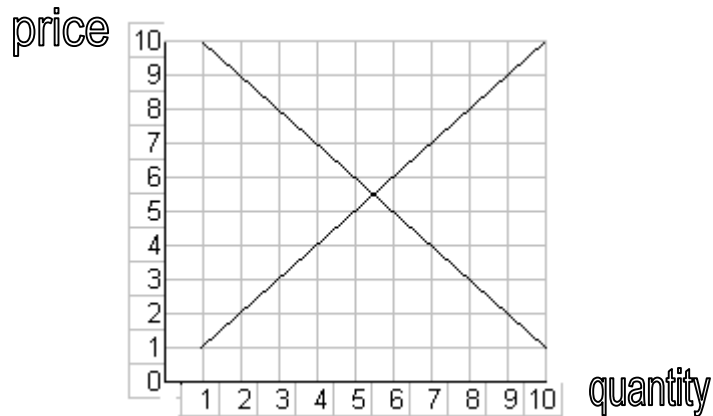
5.) Fill in the blanks. For free markets,

a.) consumer surplus is the area _____ the price and _____ the demand curve.

b.) producer surplus is the area _____ the price and _____ the supply curve.

c.) total surplus is defined as the areas of _____ plus _____.

The graph below relates to questions 6 and 7



- 6.)
- what is the equilibrium price and quantity in this graph? _____ , _____
 - Now imagine that there is a \$1.00 per unit tax imposed on buyers. What will happen in this diagram? (which curve shifts and by how much, and what will be the new equilibrium price and quantity?)
 - In the new equilibrium (after the tax) what is the effective price (that is, list price plus tax) buyers pay and what price do sellers receive?
- 7.)
- Imagine instead that there is a \$1.00 per unit tax imposed on sellers. What will happen in this diagram? (which curve shifts and by how much, what will be the new equilibrium price and quantity?)
 - What price do buyers pay and how much do sellers receive *after paying the tax*?
 - What was government revenue in the case of a tax on buyers? What is government revenue in the case of a tax on sellers?
 - Do buyers or sellers bear a bigger share of the tax burden in this case, compared to the case in question 7? Would the answer change if the demand curve were more inelastic? How?
(define the burden on buyers as new real price minus old price and define the burden on sellers as old price received minus new price received after paying the tax.)