Econ 101 Discussion Section-Handout 5

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1 Review

- Consumer Theroy

  - Individuals have to make decissions on how much they want to consume.
 - How can they decide? The have to think in their preferences and then in the market

- Preferences: A Utility model

  - The main idea is that consumption generetes satissfaction to consumers (i.e. utility)
  - Is this utility meeassurable? No in fact is subjective to each individual in each peariod of time
  - Therfore we say that utility is ordinal, it represents an order! and not a magnitud
  - Think of this order as when you are comparing two goods, do I like movies more than board game?, do I like movies less than board games? or I am indifferent?
  - Indiference is very important, we can represent along a curve all combinations that ake consumers indifferent.
  - The individual susbtitutes according to the slope of the indifference curve MRSxy

- Market: Budget Line

  - The individual faces income and prices, the slope of the bugget line is $-\frac{p_1}{p_2}$

2 Problems: Midterm and Budget Line
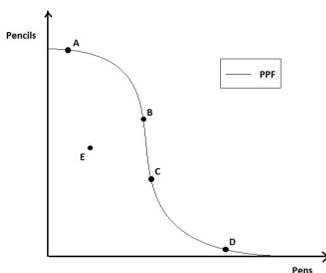
1. The opportunity cost of producing pens _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ as we move from point A to point B.

   a. Increases b. Decreases c. Remains constant d. Not enough information has been given to answer this question.

2. The opportunity cost of producing pencils _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ _ as we move from point C to point D.

   a. Increases b. Decreases c. Remains constant d. Not enough information has been given to answer this question.

3. Giffen goods

    (a) may not exist in reality. b. do not obey the Law of demand. c. occur when decreases in price cause people to buy less of the good. d. exhibit all of the properties listed above.

4. Which of the following would decrease the supply of wheat?

    (a) A fall in household incomes. b. An improvement in wheat harvesting technology. c. An increase in the price of barley. d. Wheat begins to be considered unhealthy as gluten free diets become popular.

5. Consider the market for apartments in Madison. The market demand and supply are given by the following equations. The price is in dollars per week and the quantity is in thousands. P=200-5Q Q=2

    (a) The market equilibrium price is _ _ _ _ _ _ dollars per week and the market equilibrium quantity is _ _ _ _ _ _ _ thousand apartments.

    (b) In equilibrium, consumer surplus is _ _ _ _ _ and producer surplus is _ _ _ _ _.

    (c) Suppose a law is passed that imposes a quantity limit of one thousand apartments. What is the deadweight loss of this measure?

6. In Mexico these days they are considering increasing the minimum wage. Previous studies have shown that the suggested minimum wage (i.e. the minimum wage after the increase) will not be set at an effective level. Setting a minimum wage will cause unemployment only if:

    (a) The new minimum wage is below the current market wage.

    (b) The new minimum wage is equal to the market equilibrium wage.

    (c) The new minimum wage is effective.

    (d) The minimum wage always creates unemployment.

7. Which of the following statements about elasticity is correct?

    (a) The elasticity of some variable x with respect to another variable y depends on the units of measurement of the two variables.

    (b) If a good has an upwards sloping supply curve then it has a positive elasticity of supply with respect to price.

    (c) The income elasticity of demand can never be negative, since people buy more things when they earn more money.

    (d) All of the above are true statements about elasticity.

8. 1. Simon, a Ph.D student of UW Madison, earns $1,000 per month by teaching ECON101 discussion sessions. He spends money to buy Economics Textbooks ($100 per each book) and Bucky Badger T-shirts ($20 per shirrt).

    (a) Sketch Simon's Budget Constraint, showing numbers on the axes. Also give its equation. Put textbooks on the horizontal axis. Can you give an economic interpretation of the slope of this line?

    (b) One day, the University Bookstore raised the price of Bucky T-shirts to $40. Sketch Simon's new budget constraint and give its equation.

    (c) After the price increase, UW Madison decided to raise Simon's wage to $1,200 per month. Sketch Simon's new budget constraint and give its equation.

    (d) Suppose UW Madison cuts Simon's pay in half. At the same time, the price of textbooks is reduced by 50%, as is the price of Badger T-shirts. What happens to Simon's budget line?