Chapter 6 Practice Problems Solutions

Elements of Microeconomics

Discussion section 4

Question 1

This question will consider a market for coffee, which is depicted in figure 1.

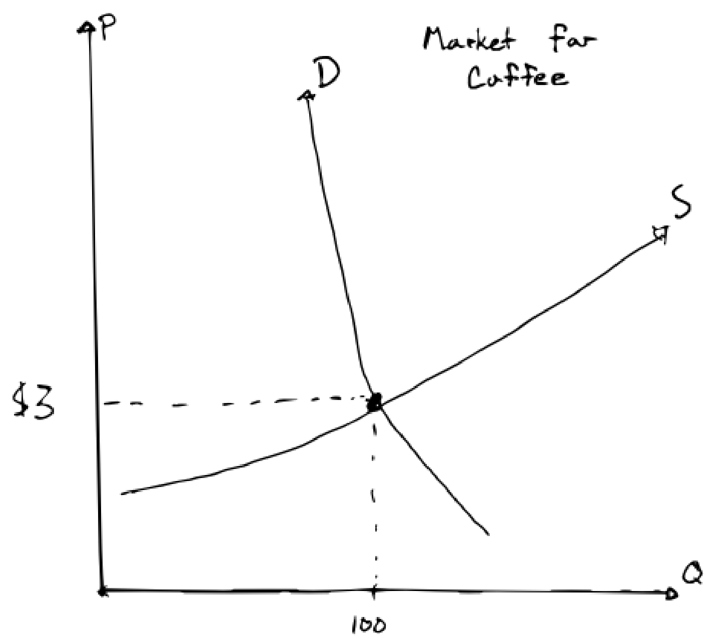

Figure 1: Market for coffee

Part A

Consider two price ceilings:

- At $2.5
- At $3.5

In both of these cases depict graphically the new market outcome, and answer:

1. What happens to the new quantity demanded and supplied?
2. Does the policy cause a shortage or a surplus?
3. Is the policy binding? Why or why not?

Part B

Repeat the same exercise but for a price *floor* at \$2.5 and \$3.5.

Question 2

Part A

Consider the market for Orioles tickets:

1. Which side is elastic?
2. Which side is inelastic?
3. What might happen in the long run?

Draw two graphs illustrating your answers, one in the short-run and one in the long-run.

Part B

Now suppose Baltimore City imposes a *binding* price floor on tickets:

1. What is the impact in the short-run?
2. What is the impact in the long-run?
3. Is the impact larger in the short-run or long-run?

Question 3

Let's consider the coffee market from Question 1 again. Instead of price controls (rare in advanced economies), consider a tax of \$0.5 per cup applied to suppliers:

1. Does this shift supply or demand curves?
2. What will happen to equilibrium price and quantity?
3. What portion falls on consumers and what falls on suppliers?

Draw a graph to illustrate the intuition behind your answers (I am not looking for specific numbers since you are not provided with functions). Make sure to draw the tax wedge, labeling the portion falling on consumers and on suppliers.

Part B

Draw two graphs to illustrate the same tax when demand is perfectly inelastic, and when supply is perfectly inelastic. Explain the intuition for who bears the tax burden and why.

Part C

Repeat this exercise, but considering the tax as levied on consumers rather than producers. Does the tax burden depend on how the tax is imposed?