



Figure 1: Coffee market

## Chapter 7 Practice Problems

Elements of Microeconomics

Discussion section 4

### Question 1

Consider Figure 1 from chapter 7 in the textbook.

What happens to the auction price if there is only one record at auction but there is another buyer, Yoko, who also values the record at \$100?

### Question 2

Consider the market for coffee in figure 1.

#### Part A

Draw the total surplus at the market equilibrium, identifying consumer surplus and producer surplus.

## Part B

Now suppose the government imposes a tax on consumption of coffee.

1. Illustrate the impact of the tax on the market equilibrium; what happens to P and Q?
2. What happens to consumer surplus?
3. Producer surplus?
4. Total surplus?

## Part C

Now suppose the government provides a subsidy to producers for each cup of coffee they sell, and answer the same questions as in Part B.

## Part D

With the two policies, does the government increase or decrease total surplus? How does the change in total surplus compare to the change in government revenue?

## Question 3

Let's consider the market for iPhones.

### Part A

Is the demand for iPhones elastic or inelastic? What about supply?

### Part B

Assume supply and demand are both fairly elastic (slope around 1). Illustrate the impact of a decrease in the cost of production, and show the change to surplus.

### Part C

Now suppose that the demand curve for iPhone is very inelastic (close to vertical), and answer the same questions.