EC201

Week 3 Discussion

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Clarification

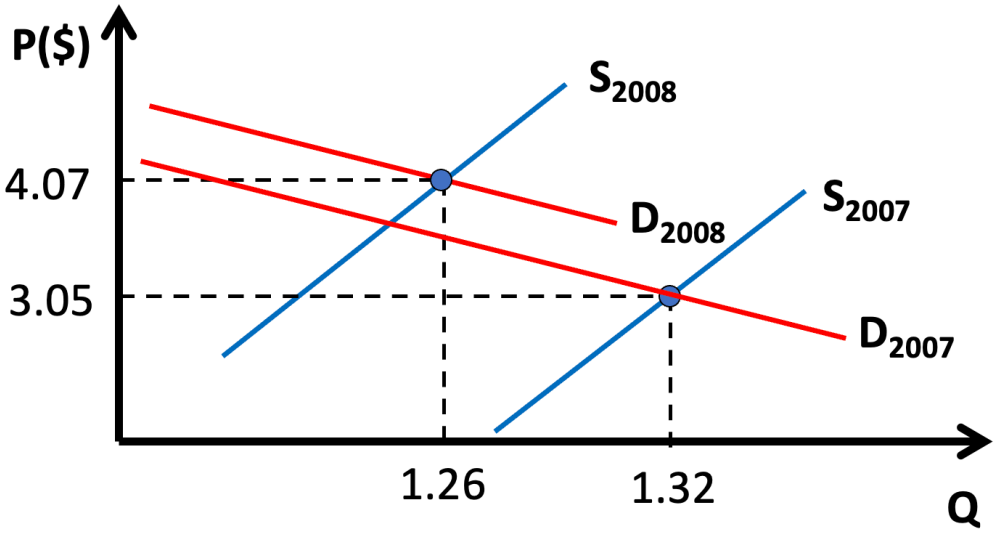
On calculating elasticity.

$$e^D = -\frac{\frac{Q_2 - Q_1}{\frac{1}{2}(Q_1 + Q_2)}}{\frac{P_2 - P_1}{\frac{1}{2}(P_1 + P_2)}}$$

Negative sign for elasticity of demand, but not for supply.

- e=0: perfectly inelastic (vertical supply curve)
- e<1: inelastic
- e=1: unit elastic
- e>1: elastic
- e=∞: perfectly elastic (horizontal supply curve)

Note we want ceteris paribus when calculating elasticity! Not like the graph below!

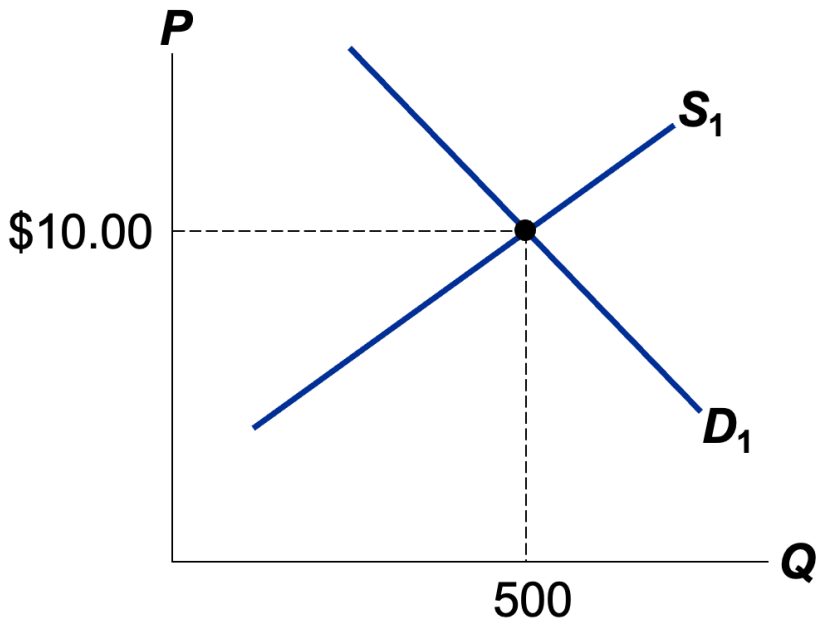


Why? Because shifting in demand curve means there are something other than price that affecting demand. But elasticity is suppose to measure the price effect!!

1. Elasticity

Year	Income	Price of bread	Quantity of bread	Price of butter	Quantity of butter
2019	50	4	8	2	9
2020	80	4	12	2	16
2021	80		10	2	10
2022	80	6	12	4	2

a. Calculate the income elasticity for bread.
b. Can you calculate the cross price elasticity for bread? If not, what extra information do you need?



2. Price floors

a. What will be a binding price ceiling? What about non-binding price ceiling.
b. What about binding and non-binding price floors?
c. If price ceilings create shortages, why are there so many of them? Why would politicians intentionally want to create non-binding price ceilings?