

Lab 5 – Tax Burdens and Foreign Exchange Rates

Elasticities Review

1. What is the formula?
2. Total Revenue:
3. So, how can you increase Total Revenue with elastic demand?

Inelastic demand?

Tax Burdens

1. Tax shifting occurs when a tax levied on sellers of a good causes the market price of the good to increase
 - a. The effect of a per unit tax is the same as the effect of having the price of an input increase by the amount
 - b. Shifts the supply curve upward by the per unit tax
2. Suppliers bear all the burden when:
 - a. Perfectly Inelastic Supply:
 - b. Perfectly Elastic Demand:
3. Demanders bear all the burden when:
 - a. Perfectly Elastic Supply:

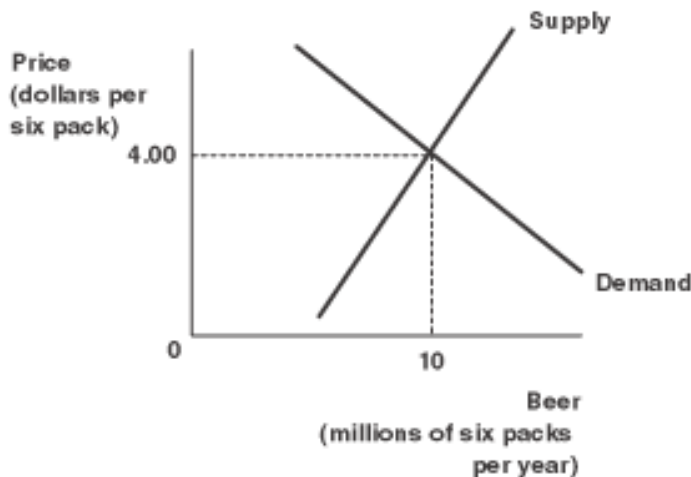
- b. Perfectly Inelastic Demand:

Foreign Exchange Market

1. A market in which buyers and sellers of bank deposits denominated in the monetary units of many nations exchange their funds
2. Foreign Exchange Rate is the price of one nation's monetary unit in terms of the monetary unit of another nation
3. Calculating currency conversion:
4. We can graph this just like we did with regular Demand/Supply graphs, the axis change though:
5. Assume the domestic price of a good stays constant. What will happen to the price of foreign goods when the foreign exchange rate increases? Or decreases?

Problems

1. If the demand for Carolina Hurricanes hockey pucks is elastic, and the price of the pucks increases, total revenue will _____
2. If the demand for orange juice is inelastic, total consumer expenditure on orange juice will _____ as price increases
3. The graph below shows the demand and supply curves for beer.



The current market price is \$4 per six pack, and 10 million six packs are sold per year. A new tax of \$1 per six pack is levied, which shifts the supply curve upward by \$1 for each possible quantity. As a result of the tax,

- a. The price of beer will rise by \$1, but there will be no effect on the quantity of beer demanded
 - b. The market price of a six pack will rise by \$1
 - c. The market price of a six pack will rise by an amount less than \$1
 - d. The price of beer will rise by an amount less than \$1, but there will be no effect on the quantity of beer demanded
 - e. There will be no effect on either price or the quantity of beer demanded
4. A \$1 per gallon tax on the sale of gasoline will raise the price of gasoline by exactly \$1 if supply is _____ or demand is _____
 5. Suppose the exchange rate between yen and dollars is currently set at 125 yen per dollar. If a Japanese tourist in Seattle purchases a commodity that sells for \$250, this would cost the equivalent of how many yen?

6. Suppose 1 dollar is worth 10 francs and 120 yen. In this case, it would be expected that 1 franc is worth

7. The graph below shows the demand and supply curves for dollars (in terms of yen) in the foreign exchange market. Suppose there is an increase in U.S. exports to Japan. Draw the subsequent shift in either the supply or demand curve. [Hint: think of imports/exports in terms of income]



8. Draw a hypothetical Supply and Demand graph of Red Bull. Make sure your Supply slopes upward and Demand slopes downward, but the actual slope doesn't matter for this example. Label the equilibrium price P_0 and quantity Q_0 .
- Suppose the price of Jägermeister goes down. Shift the curves appropriately.
 - In addition to the price of Jägermeister decreasing, suppliers expect that the price will increase next week because Snooki is coming into town. Shift the curves appropriately.
 - Can we say anything definite about price? What about quantity?