

- 2) The price of gasoline is \$2.00 and the price elasticity of demand is -0.4.
- a) How much will a 10% reduction in quantity placed on the market increase the price?

- b) If -0.4 is a short run elasticity, do you expect that this price increase brought about by this reduction in quantity will be more or less in the long run (remembering that things tend to become more elastic in the LR than the SR). Why?

- 3) Say we know that the current price elasticity of demand for Twinkies is -9.0 .
- a) Is the price elasticity of demand for Twinkies inelastic or elastic?

- b) How much would purchases fall from their current level of 100 million units / day if the price of Twinkies is increased by 10%?

4) Ice Scream: Milk-Fat Prices Raise Cost of Summer Treat

Wall Street Journal; New York, N.Y.; Jul 24, 2001;

Just when you really, really want an ice cream cone, the price is rising. But it isn't summertime gouging by manufacturers. The cost of milk fat, the principal ingredient in ice cream, jumped 71% during the past six months to \$2.22 at the end of June. As a result, retail prices are up 4% from last year, manufacturers say, triggering a 3% drop in consumption.

Based on the information presented above, answer the following questions.

- a) Draw a supply and demand graph representing the situation in the retail ice cream market before the milk fat price rise. Illustrate on this graph where the impact of the milk fat price rise will manifest itself in the retail ice cream market.

- b) What is the implied price elasticity of demand for ice cream based on the information in the last sentence?

- c) Is the computed elastic inelastic, unit elastic, or elastic?

- 6) Impose a specific tax of size τ on producers. Illustrate the areas corresponding to consumer surplus, producer surplus, and deadweight loss both before and after the tax is imposed.