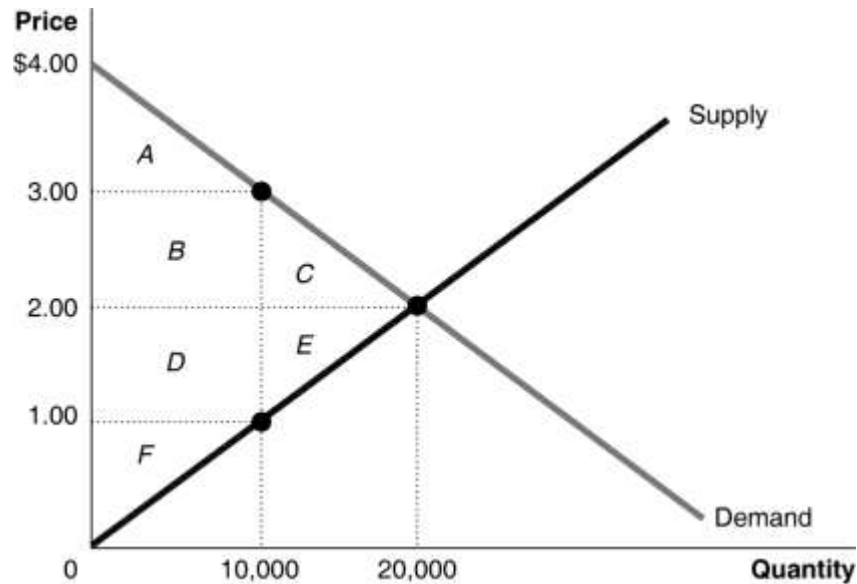


Problem Set Unit 1 and Unit 2

1. Newspaper item: "Due to higher grain prices, consumers can expect retail prices of choice beef to begin increasing slightly this spring with pork becoming more expensive after midsummer," the Agriculture Department predicted. "This reflects decreasing supply," the department said. Does the statement use the term "supply" correctly? What effects might this announcement have on consumer demand? Fully explain your answer, a simply yes or no is not adequate. Your answer must be supported with graphs. (25 points)
2. The owner of a restaurant is considering lowering menu prices to draw in more customers. He is debating between lowering the price for the steak entrée or the salmon entrée. When he lowered prices last year, a \$2.00 decrease in price for the \$15 steak resulted in a growth in steak sales from 75 per week to 100 per week. A \$2.50 decrease in the price of the \$17 salmon entrée increased sales from 40 to 75 meals per week. Which entrée should he choose to put on sale? And why? (Be sure to include the effect on total revenue and the price elasticity of demand) No graph is needed. (25 points)
3. Use the graph to answer the questions in the chart below. (25 points)



Calculate the area of the following. Be sure to show all calculations:

- a. What is the area of the producer surplus after a binding price floor?
 - b. What is the area of the consumer surplus before a price floor?
 - c. What is the area of deadweight loss after a binding price floor?
4. By 2009, 23 states, including California, Florida, Massachusetts, and New York, had enacted laws to prohibit smoking in workplaces. But Ike's Bar-B-Q Pit is not located in any of these states. Some of Ike's non-smoking customers, including some who suffer from asthma, have petitioned Ike to adopt a no-smoking rule for his restaurant. Upon

hearing of the petition, some of Ike's other customers complained that they have smoked in Ike's restaurant for years and would not patronize the restaurant if the no-smoking rule were adopted. Ike is greatly concerned because he does not wish to lose business from either his smoking or non-smoking customers. (Source: Americans for Nonsmokers' Rights, <http://www.no-smoke.org>)

- A. Draw a graph illustrating the externality associated with Ike's Bar-B-Q Pit and explain how this externality causes a deviation from economic efficiency in this market.