

ARE 201 Spring 2009 Exam #2 Answer Sheet

MULTIPLE CHOICE (3 points each)

1. c
2. b
3. b
4. b
5. a
6. d
7. d
8. a
9. d
10. b
11. a
12. c
13. b
14. c

TRUE/FALSE (2 points each)

1. T
2. F
3. F
4. F
5. T
6. T
7. T

SHORT ANSWER

APPLICATION/SCENARIO (12 points each)

1. ANSWER:

$$\frac{\frac{10 - 8}{(10 + 8) / 2}}{\frac{4500 - 4000}{(4500 + 4000) / 2}} = 1.89$$

The income elasticity of demand for the Shaffers is 1.89. Since the income elasticity of demand is positive, this would be interpreted as a normal good.

2. ANSWER:

- a. For this example, a \$300 price ceiling would cause a shortage of 4,000 bicycles. A price ceiling is binding if it is set at any price below equilibrium price. Since the equilibrium price in the market is \$500, this would be a binding price ceiling.

- b. For this example, a \$700 price floor would cause a surplus of 4,000 bicycles. A price floor is binding if it is set at any price above equilibrium price. Since the equilibrium price in the market is \$500, this would be a binding price floor.
- c. More than one reason may exist for policymakers to impose a price ceiling or price floor in a market. Often this is done in an attempt to increase equity.