

Study Questions for Term Test 2

1. Suppose that a 20 percent increase in the price of normal good A causes a 10 percent increase in the quantity demanded of normal good B. The coefficient on the cross elasticity of demand is:
 - A) negative and therefore these goods are substitutes.
 - B) negative and therefore these goods are complements.
 - C) positive and therefore these goods are substitutes.
 - D) positive and therefore these goods are complements.

2. Text book chapter 4 Question 7

Suppose the demand for bagels rises dramatically while the demand for breakfast cereal falls. Briefly explain how the competitive market economy will make the needed adjustments to re-establish an efficient allocation of society's scarce resources. Use graphs.

3. Text book chapter 4 Question 9

In a single sentence, describe the meaning of the term "invisible hand."

4. Text book chapter 5 question 6

Suppose that the comparative cost ratios of two products (baby formula and tuna fish) are as follows in Canada and Taiwan:

Canada: 1 can baby formula=2 cans tuna fish

Taiwan: 1 can baby formula=4 cans tuna fish

In what product should each nation specialize?

Explain why the terms of trade, 1 can baby formula : 2.5 cans tuna fish, would be acceptable.

5. Text book chapter 5 Question 7

"Canadian exports create a demand for foreign currencies; Foreign imports of Canadian goods generate supplies of foreign currencies." Do you agree?

Would a decline in Canadian incomes or a weakening of Canadian preference for foreign products cause the dollar to depreciate or appreciate?

What would be the effects of that depreciation or appreciation on Canadian exports and imports?

6. Text book chapter 5 Question 11

Identify and state the significance of each of the following:

- a. WTO, b. EU c. NAFTA

What commonality do they share?

7. Text book chapter 6 question 2

Graph the demand data below and then use the midpoints formula to determine the price elasticity of demand for each of the four possible \$1 price changes.

What can you conclude about the relationship between the slope of a curve and the elasticity?

Explain in a non-technical way why demand is elastic in the northwest segment of the demand curve and Inelastic in the southeast segment.

<u>Price</u>	<u>Quantity</u>
5	1
4	2
3	3
2	4
1	5

8. Text book chapter 6 Question 4

Calculate total revenue data from the demand schedule in the question above. Graph the total revenue below your demand curve. Generalize the relationship between price elasticity and total revenue.

9. Text book chapter 6 Question 5

How would each of the following changes in price affect total revenue. Would total revenue increase, decrease or remain unchanged?

- a. Price falls and demand is inelastic
b. Price rises and demand is elastic

- c. Price rises and supply is elastic
- d. Price rises and supply is inelastic
- e. Price rises and demand is inelastic
- f. Price falls and demand is elastic
- g. Price falls and demand is of unit elasticity

10. Text book chapter 6 Question 12

Suppose the cross elasticity of demand for products A and B is +3.6 and for products C and D it is -5.4. What can you conclude about how products A and B are related? Products C and D?

11. Text book chapter 6 Question 13

The income elasticities of demand for movies, dental services and clothing have been estimated to be +3.4, +1.0 and +0.5 respectively. Interpret these coefficients. What does it mean if the income elasticity coefficient is negative?