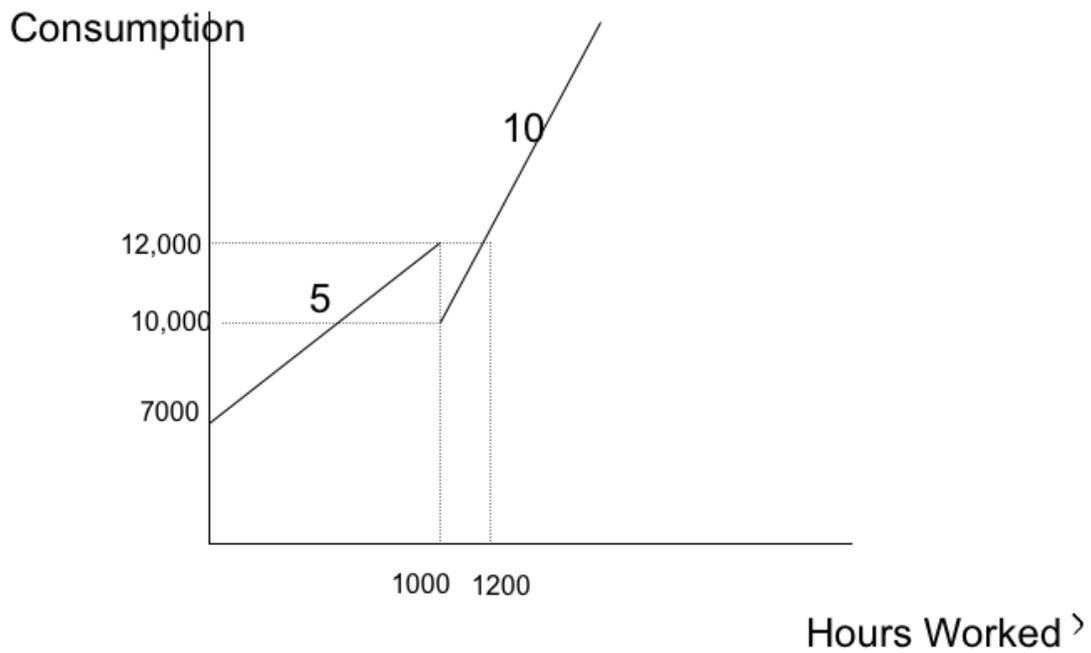


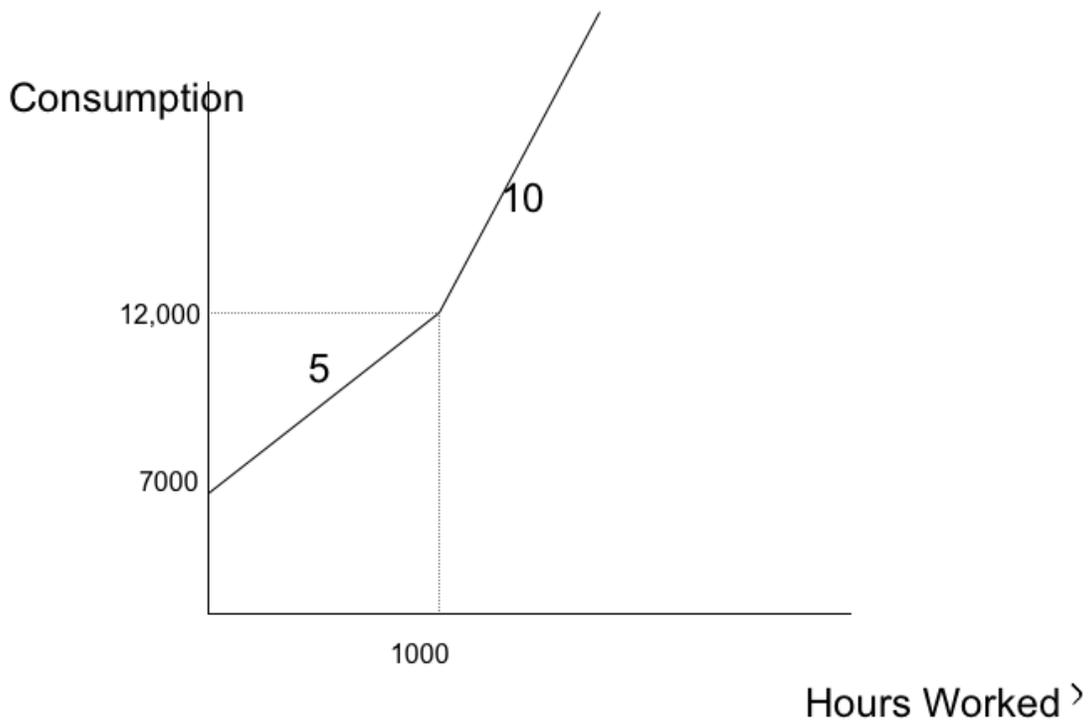
Economics 131
Solutions previous final
Spring 2013

Question 1

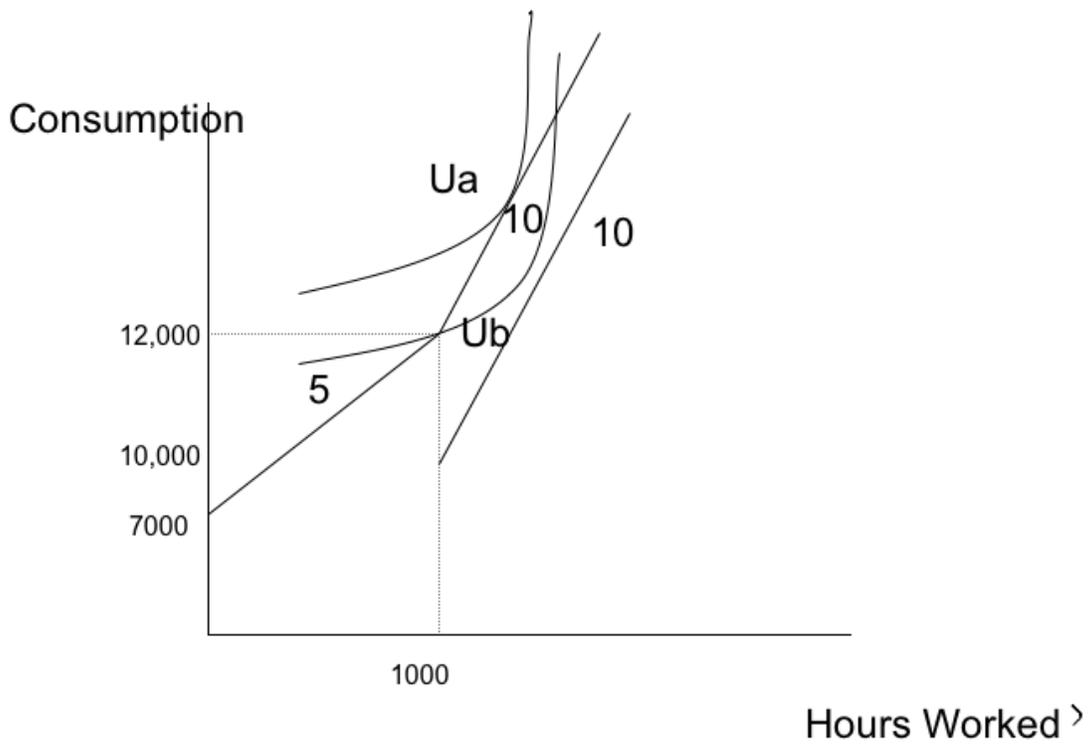
1a Pam will not work between 1000 and 1200 hours because whatever she can earn while working in that range she can earn as much while working less.



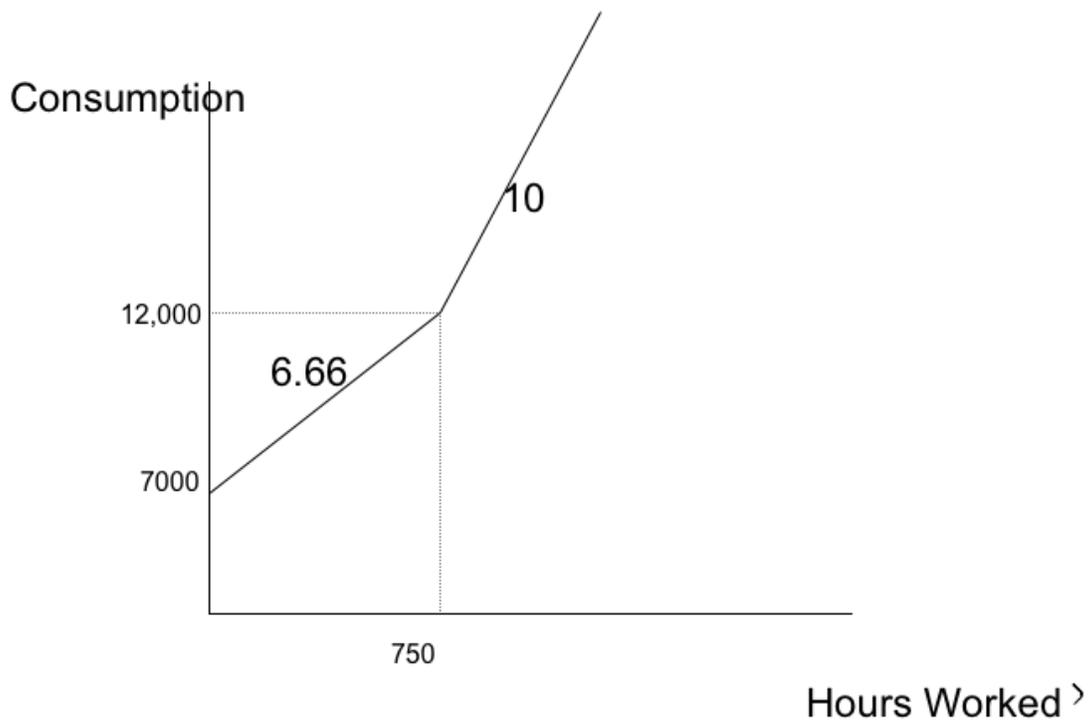
1b



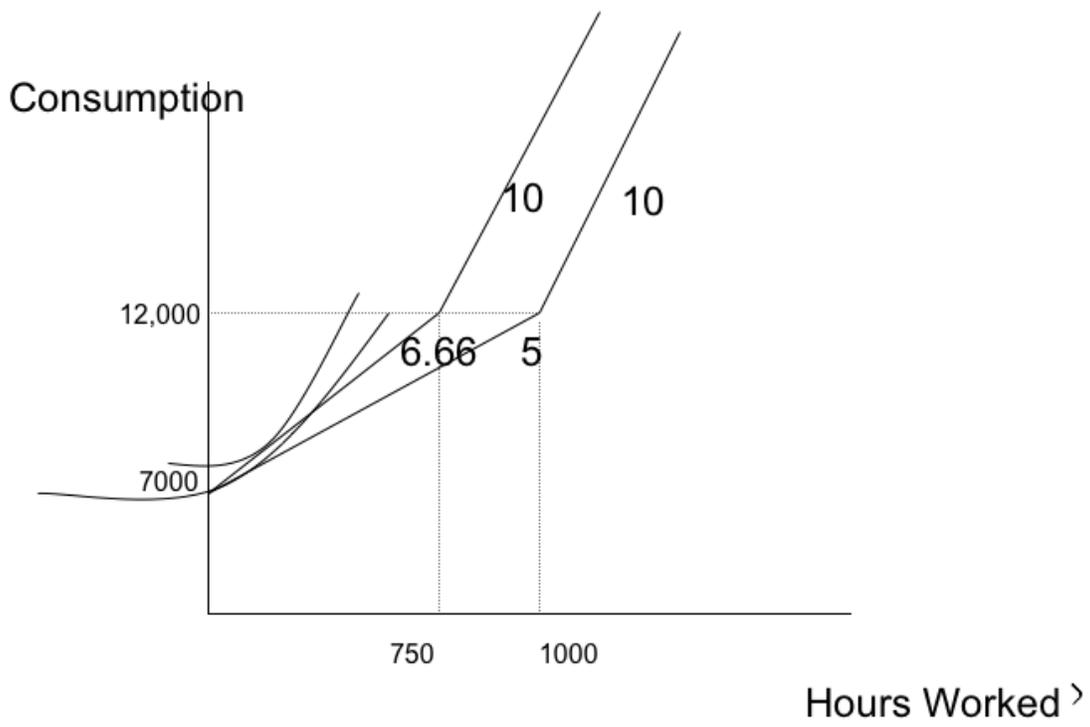
As can be seen from the indifference curves drawn below, for certain preferences Pam will work more since the change in policy allows her to reach a higher indifference curve (U_a instead of U_b), going from working at the point of discontinuity (1000 hours) before the policy change to the number of hours determined by the tangency of U_a and the line with a slope of 10.



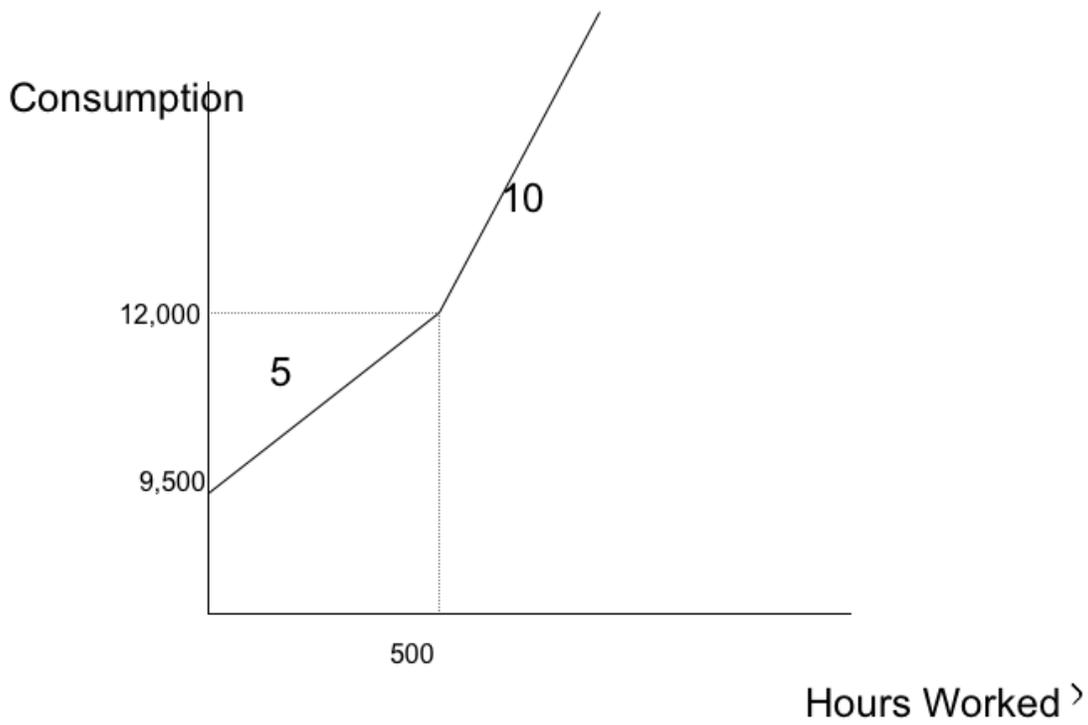
1c



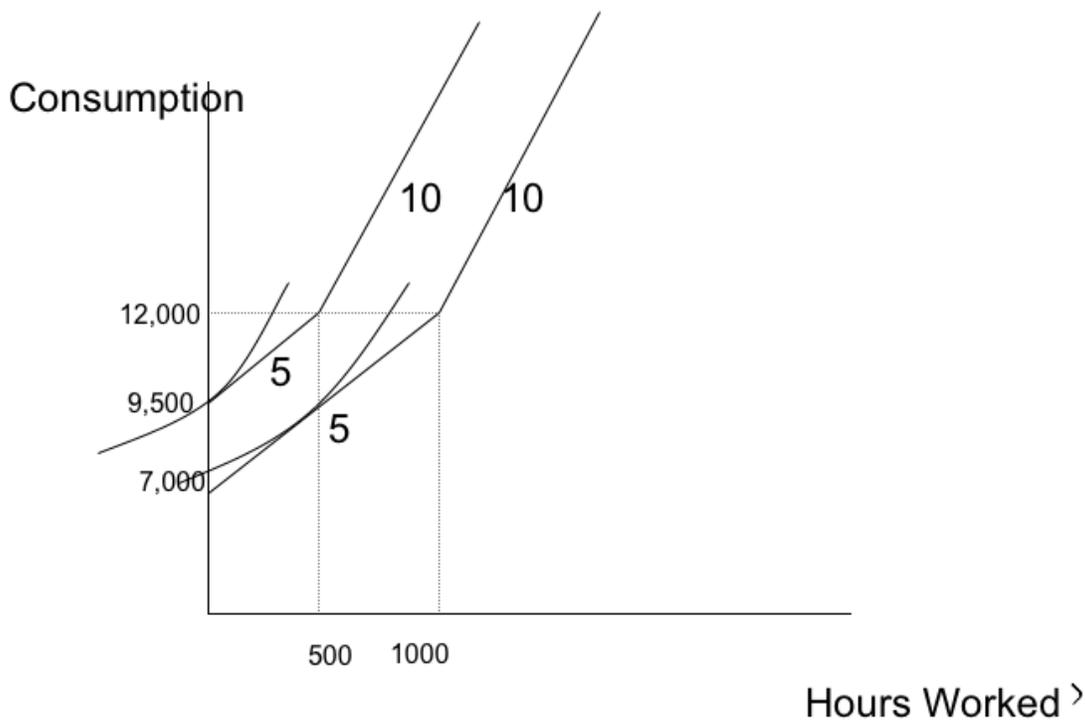
For certain preferences, Pam may choose to work given the policy change in c whereas she wouldn't have in part b. See the depiction of such a scenario below, as represented by the two indifference curves, one with tangency at 0 hours of work, the other with a tangency with positive hours of work. In such a scenario, Pam relies on welfare benefits less under policy c than policy b. A similar depiction can be drawn further to the right on the graph (you should do this yourself), moving Pam from a point where she still receives some welfare benefits under policy b to a higher indifference curve at which she is receiving no welfare benefits under policy c.



1d



For certain preferences, such as those represented by the indifference curves below, Pam may now choose not to work under policy d while she would have worked under policy b. Intuitively, she can now enjoy greater consumption without working than before due to the additional child support benefits, so may decide to forgo the work she would have done and enjoy the extra labor-free income.



Question 2

a

The higher gas prices, the less likely people are to drive cars driving future automobile industry revenues down.

b The senate is assuming that the tax is entirely born by the consumers, it relies heavily on the market structure being one of perfect competition. If these assumptions are wrong, the tax cuts will benefit suppliers.

c Under this plan, we are sure that the money will benefit consumers and not suppliers. However it might benefit people who do not drive cars who would not have benefited from Senate plan. In addition, drivers who consume less gas benefit more from the plan. In the long run, the Senate plan is more beneficial for consumers as they are able to enjoy lower prices for the rest of their life. The 100 dollar check will only benefit them for one year.

e

The statutory incidence of the tax does not matter for who will eventually bear the economic incidence of the tax. The only thing that matters are the elasticities of demand and supply with

respect to the price. Since they are not affected, the sticker price should not change.