

Applied Microeconomics Problem Set With Solutions

Applied Microeconomics Problem Set With Solutions Applied Microeconomics Problem Set with Solutions This problem set is designed to help students develop their understanding of applied microeconomics concepts and apply them to realworld situations It covers a range of topics including consumer theory producer theory market structure and welfare economics The problems are designed to be challenging but solvable with careful application of the tools and concepts presented in class Solutions are provided for each problem to facilitate understanding and encourage learning

Section 1 Consumer Theory

Problem 1 Sarah has 100 to spend on two goods books and coffee The price of a book is 10 and the price of a cup of coffee is 5 Sarahs utility function is $U(B, C) = 5B^{0.5}C^{0.5}$ where B represents the number of books and C represents the number of cups of coffee

a What is Sarahs budget constraint

b Find Sarahs optimal consumption bundle

c What is Sarahs utility level at the optimal consumption bundle

Solution a Sarahs budget constraint is $10B + 5C = 100$

b To find the optimal consumption bundle we need to find the point where Sarahs indifference curve is tangent to her budget constraint This means finding the point where the marginal rate of substitution MRS equals the price ratio The MRS is the ratio of the marginal utility of books to the marginal utility of coffee $MRS = \frac{MUB}{MUC} = \frac{0.5 \cdot 5^{0.5} B^{-0.5} C^{0.5}}{0.5 \cdot 5^{0.5} B^{0.5} C^{-0.5}} = \frac{C}{B}$ The price ratio is $\frac{P_B}{P_C} = \frac{10}{5} = 2$ Setting the MRS equal to the price ratio we get $\frac{C}{B} = 2$ or $C = 2B$ Substituting this into the budget constraint we get $10B + 5(2B) = 100$ or $B = 5$ Plugging this value back into the equation $C = 2B$ we get $C = 10$ Therefore Sarahs optimal consumption bundle is 5 books and 10 cups of coffee

c Sarahs utility level at the optimal consumption bundle is $U(5, 10) = 5 \cdot 5^{0.5} \cdot 10^{0.5} = 5 \cdot 2.236 \cdot 3.162 = 35.36$

Problem 2 Suppose the price of books increases to 15 How does this affect Sarahs optimal consumption bundle

Solution With the price of books increasing the budget constraint becomes steeper This means Sarah can now buy fewer books for the same amount of money The new budget constraint is $15B + 5C = 100$ Repeating the steps from Problem 1 we find the new optimal consumption bundle is B = 4 and C = 8 Sarah now buys fewer books 4 instead of 5 and fewer cups of coffee 8 instead of 10 due to the higher price of books

Section 2 Producer Theory

Problem 3 A firm produces output using two inputs labor L and capital K Its production function is $Q = L^{0.5}K^{0.5}$ The price of labor is 10 and the price of capital is 20

a Find the firms total cost function

b Find the firms marginal cost function

c If the firm wants to produce 100 units of output how

much labor and capital should it use Solution a The total cost function is the sum of the cost of labor and the cost of capital $TC = wL + rK$ where w is the wage rate r is the rental rate of capital and L and K are the quantities of labor and capital used Substituting the given values we get $TC = 10L + 20K$ b The marginal cost function is the change in total cost divided by the change in output $MC = \frac{\Delta TC}{\Delta Q}$ To find this we first need to find the firms costminimizing input combination for a given level of output This is achieved by setting the ratio of marginal products equal to the ratio of input prices $\frac{MPL}{MPK} = \frac{w}{r}$ The marginal product of labor is $MPL = 0.5L^{-0.5}K^{0.5}$ and the marginal product of capital is $MPK = 0.5L^{0.5}K^{-0.5}$ Plugging these into the equation above we get $0.5L^{-0.5}K^{0.5} = \frac{10}{20} \cdot 0.5L^{0.5}K^{-0.5}$ or $K = 2L$ Substituting this into the production function we get $Q = L^{0.5}2L^{0.5} = 2L$ Solving for L we get $L = \frac{Q^2}{4}$ Plugging this back into the equation $K = 2L$ we get $K = \frac{Q^2}{2}$ Therefore the costminimizing input combination for a given level of output Q is $L = \frac{Q^2}{4}$ and $K = \frac{Q^2}{2}$ Substituting these into the total cost function we get $TC = 10\left(\frac{Q^2}{4}\right) + 20\left(\frac{Q^2}{2}\right) = 15Q^2$ The marginal cost function is therefore $MC = \frac{\Delta TC}{\Delta Q} = 30Q$ c To produce 100 units of output the firm should use $L = 100^2/4 = 2500$ units of labor and $K = 100^2/2 = 5000$ units of capital Section 3 Market Structure Problem 4 A monopolist faces a demand curve of $P = 100 - Q$ where P is the price and Q is the quantity Its total cost function is $TC = 10Q$ a What is the monopolists profitmaximizing price and quantity b What is the monopolists profit c What is the deadweight loss associated with the monopolists output Solution a The monopolists profit is maximized where marginal revenue MR equals marginal cost MC Total revenue TR is equal to price times quantity $TR = P \cdot Q = (100 - Q) \cdot Q = 100Q - Q^2$ Marginal revenue is the change in total revenue divided by the change in quantity $MR = \frac{\Delta TR}{\Delta Q} = 100 - 2Q$ Marginal cost is the change in total cost divided by the change in quantity $MC = \frac{\Delta TC}{\Delta Q} = 10$ Setting MR equal to MC we get $100 - 2Q = 10$ or $Q = 45$ Substituting this value back into the demand curve we get $P = 100 - 45 = 55$ Therefore the monopolists profitmaximizing price is 55 and its quantity is 45 units b The monopolists profit is equal to total revenue minus total cost $TR - TC = 55 \cdot 45 - 10 \cdot 45 = 2025 - 450 = 1575$ c The deadweight loss associated with the monopolists output is the difference between the consumer surplus in a perfectly competitive market and the consumer surplus in a monopolistic market In a perfectly competitive market the price would be equal to marginal cost which is 10 This would lead to a quantity of 90 units $100 - P = 10 \Rightarrow P = 90$ The consumer surplus in a perfectly competitive market is equal to the area of the triangle between the demand curve and the price line which is $\frac{1}{2} \cdot 90 \cdot (100 - 90) = 4050$ The consumer surplus in a monopolistic market is equal to the area of the triangle between the demand curve and the price line which is $\frac{1}{2} \cdot 45 \cdot (100 - 55) = 101250$ The deadweight loss is therefore $4050 - 101250 = -303750$ Section 4 Welfare Economics Problem 5 4 The government is considering imposing a tax on gasoline to

reduce pollution The current price of gasoline is 3 per gallon and the demand curve is $Q = 100 - 2P$ The supply curve is $Q = 4P - 12$ a What is the consumer surplus and producer surplus before the tax b What is the optimal tax rate that maximizes government revenue c What is the deadweight loss from the tax at the optimal tax rate Solution a To find the equilibrium price and quantity before the tax we set demand equal to supply $100 - 2P = 4P - 12$ Solving for P we get $P = 18.67$ Substituting this back into either the demand or supply equation we get $Q = 62.67$ Consumer surplus is the area of the triangle between the demand curve and the price line which is $\frac{1}{2} (100 - 62.67) (18.67 - 3) = 254.056$ Producer surplus is the area of the triangle between the supply curve and the price line which is $\frac{1}{2} (62.67 - 3) (18.67 - 3) = 490.56$ b The optimal tax rate that maximizes government revenue is the tax rate that leads to a half reduction in the quantity demanded This is because the tax revenue is maximized when the elasticity of demand is unitary In this case the elasticity of demand is $2P/Q = 2(18.67/62.67) = 0.6$ To achieve unitary elasticity the price needs to increase by $1/0.6 = 1.67$ Therefore the optimal tax rate is 1.67 per gallon c The deadweight loss from the tax is the loss in consumer and producer surplus due to the reduction in quantity traded The new equilibrium quantity after the tax is $Q = 42.67$ The deadweight loss is equal to the area of the triangle between the demand and supply curves which is $\frac{1}{2} (62.67 - 42.67) (18.67 - 16.67) = 166.7$ Conclusion This problem set has provided students with an opportunity to apply microeconomic concepts to realworld scenarios By working through these problems and understanding the solutions students can develop a deeper understanding of economic principles and their practical applications Further Study Students interested in further exploring applied microeconomics can delve into topics such as game theory behavioral economics and the economics of information These topics are highly relevant to understanding the complexities of modern markets and can provide valuable insights into decisionmaking in various contexts 5 This article is an example of how to create a structured 1000word article with a problem set You can adapt it to your specific needs by changing the problems solutions and sections Remember to include clear explanations diagrams and realworld examples to enhance understanding

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lecture notes in microeconomic theory is the first publication of ariel rubinstein s lecture notes from the first part of his well known course in microeconomic theory which he has taught for fifteen years to first year graduate students at tel aviv princeton and new york universities the book will be an invaluable supplement to primary textbooks in microeconomic theory conveying the style and method of rubinstein s lectures it will benefit teachers and research economists as well as students the book focuses on and provides a critical assessment of models of rational economic agents and it contains a large number of original problems rubinstein one of the world s most respected economics theorists has made substantial contributions to several fields in economics particularly game theory his work is characterized by an unusual combination of deep originality and surprising simplicity he is probably best known for his contributions to the bargaining problem and more recently to bounded rationality

microeconomic theory a heterodox approach develops a heterodox economic theory that explains the economy as the social provisioning process at the micro level heterodox

microeconomics explores the economy with a focus on its constituent parts and their reproduction and recurrence their integration qua interdependency by non market and market arrangements and institutions and how the system works as a whole this book deals with three theoretical concerns due to the significance of the price mechanism to mainstream economics a theoretical concern of the book is the business enterprise markets demand and pricing also since heterodox economists see private investment consumption and government expenditures as the principal directors and drivers of economic activity a second theoretical concern is business decision making processes regarding investment and production government expenditure decisions the financing of investment the profit mark up and the wage rate and taxes finally the third theoretical concern of the book is the delineation of a non equilibrium disaggregated price output model of the social provisioning process this book explores the integration of these various theories with a theoretical model of the economy and how this forms a theory that can be identified as heterodox microeconomics it will be of interest to both postgraduates and researchers

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this work acts as a critique of the basis of neoclassical microeconomics and makes a proposal for the structure of a new evolutionary theory

based on the belief that economics is a way of thinking this text motivates students with clear explanations good graphs lively writing and interesting and relevant examples this edition features a logical organization of topics an accessible presentation and a hands on focus to help students learn how to solve problems and think analytically the abundance of real world examples and coverage of current issues both show students how relevant economic concepts are to their lives and their world a comprehensive high quality ancillary package is available providing all the tools necessary to encourage critical thinking

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