

1. (Gwartney, p. 78, #2) What is being held constant when a demand curve for a specific product (shoes or apples, for example) is constructed? Explain why the demand curve for a product slopes downward to the right. (We gave two reasons in class—explain them both.)
2. (McEachern, p. 93, #12) Using demand and supply curves, show the effect of each of the following on the market for cigarettes.
 - a. A cure for lung cancer is found.
 - b. The price of cigars increases.
 - c. Wages increase substantially in states that grow tobacco.
 - d. A fertilizer that increases the yield per acre of tobacco is discovered.
 - e. There is a sharp increase in the price of matches, lighters, and lighter fluid.
 - f. More states pass laws restricting smoking in restaurants and public places.
3. The Cash for Clunkers program run by the federal government last year gave consumers approximately a \$4,000 rebate on the purchase of a new fuel efficient car if they simultaneously turned in a used car which received less than 18 miles per gallon. A recent article in the *U.S.A. Today* (August 10, 2009) notes, “the clunker program could cause prices [of used cars] to rise 5% to 10% ... says Alec Gutierrez, senior market analyst for Kelley Blue Book. ‘It’s going to drive prices up of some of the most affordable vehicles we have on the road.’” The article notes that the price rise is not only due to the government program but also to weak economic conditions (consumers’ real incomes are down).
 - a. Illustrate how (i) the government program and (ii) lower consumer income affect the market for used cars using a supply and demand diagram. What can you say about the price of used cars? What about the quantity bought and sold?
 - b. What if this program took place in a strong economy (consumers’ real incomes were higher) instead of a weak one. Now what could you say about the price of used cars and the quantity bought and sold?
4. (Based on Gwartney, p. 103, #8) Even though it is illegal to buy and sell kidneys in the United States, we can still talk about the “market” for these organs.
 - a. Draw the demand curve for kidneys and the supply curve of kidneys on one graph. Do they obey the laws of supply and demand? Then show the effects of a ban on the buying and selling of kidneys (Hint: this is equivalent to a price ceiling.)
 - b. How do you think the market for kidneys would be affected if it was made fully legal with a well-functioning price mechanism? What would be the advantages and disadvantages relative to the current system?
5. (Mankiw, p. 111, #9) The *New York Times* reported (Feb. 17, 1996) that subway ridership declined after a fare increase: “There were nearly four million fewer riders in December 1995, the first full month after the price of a token increased 25 cents to \$1.50, than in the previous December, a 4.3 percent decline.”
 - a. Use these data to estimate the price elasticity of demand for subway rides.
 - b. According to your estimate, what happens to the Transit Authority’s revenue when the fare rises?
 - c. Why might your estimate of the elasticity be unreliable?