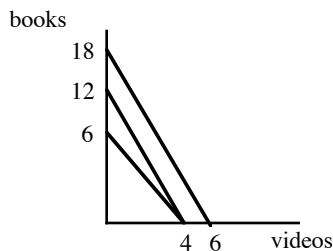
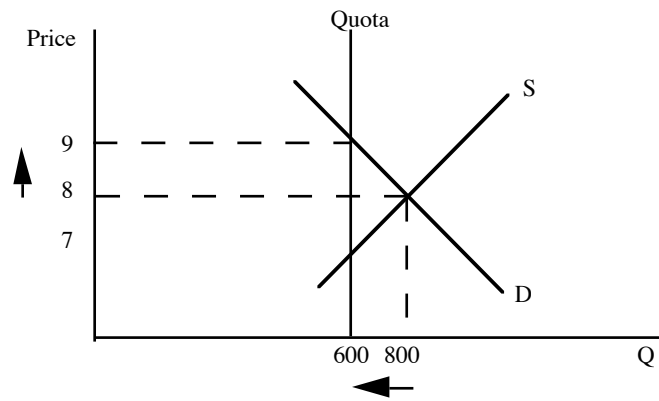


Answers to Test #1

- A. (1) False. Quantity will increase.
 (2) False. The price of bacon will decrease.
 (3) True. As a fixed amount is divided by a larger and larger quantity, the ratio must decrease.
 (4) False. The price will be lower if the price ceiling is binding. If the price ceiling is nonbinding, the price and quantity will be unaffected.
- B. (1) e.g., gas stations; they are numerous, sell a product that is differentiated by location of the station, and it is easy to enter and exit the industry.
 (2) Substitute labor for capital in production until the ratios are equal.
 (3) See Ch. 10, p. 195, for a list of barriers to entry. I also include illegal restrictions.
 (4) treating groups of people who have different demand conditions and who can be identified as group members differently, e.g., student discounts or senior discounts for movie tickets.
- C. (1) a (2) b (3) b (4) c (5) a



- D. If he views books and videos as perfect substitutes, he will prefer the three points on the vertical axis because he gets the most units that way (i.e., books are cheaper).



E. (1) and (2)

(3) $e = (-200/1800)/(1/15) = -1.67$ (or 1.67 in absolute value)

(4) demand will increase (shift to the right), price will rise, quantity will rise. Note that the domestic lava lamp is a different (substitute) market than the imported lava lamp market analyzed in the first three parts of this problem.