

ECO135 (04) Quiz 3 January 4, 2019 ID _____; NAME _____

1. Suppose that $P_x = 20$, $P_y = 10$ and $I = 1000$.

(a) Draw the budget line by specifying (i) x-intercept and (ii) y-intercept.

(b) Let's now suppose that P_y increased to 15. Draw the new budget line on the figure from (a). Clearly specify x and y intercepts. Add necessary curves (2 indifference curves) and a line (one extra budget line) to the figure and show (i) Substitution Effect (ii) Income Effect (iii) Total Effect. Explain if Substitution or Income Effect Dominates.

2. If Mehmet's Marginal Rate of Substitution of Y for X is 8 and $P_x = 50$, $P_y = 5$. "He is spending too much of his income on Y." Do you agree with this statement? Explain.