

31E99906 Capstone Microeconomic Policy

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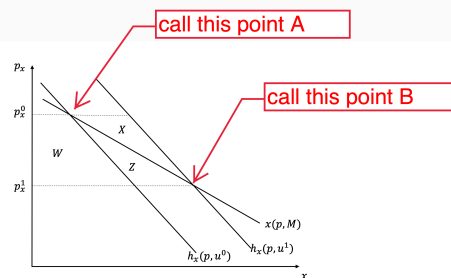
TA: William Ogden

Return method: through mycourses by the deadline

### Problem Set 1: Question 1

The consumer theory: consumer choices, CV, and EV. These are simple control questions on the first lecture material.

- Figure below shows the relationship between CV, EV, and the consumer surplus change from a price decrease. Marshallian demand intersects with the two Hicksian demands as depicted. Why is this? You may draw a picture.
- Why is the Hicksian demand associated with  $u^1$  higher than the one associated with  $u^0$ ? (“higher”=more demand at given price). Recall that the new situation is denoted by superscript 1 and the old by 0.
- The Figure below depicts a situation where the price of  $x$  decreases. Please draw the corresponding Figure for a price increase, and explain the items in it.
- Can you redraw the figure below for a price increase? Please explain the relationship between CV, EV, and CS in that case.



Note:  $EV=W+Z+X$ ,  $CV=W$ ,  $\Delta CS = W + Z$