ECON 224, Professor Hogendorn

Problem Set 1

1. *JFK*. You take a job with a cargo company at JFK Airport in New York City. JFK's air cargo business has been suffering in recent years because new aircraft are able to fly directly from international destinations to interior U.S. airports such as Memphis and Kansas City. Some of the other cargo firms serving JFK decide to petition the Port Authority of New York and New Jersey to intervene in the market. Based on your economics training, you believe that demand is quite elastic (because there are many substitute airports) and supply is inelastic (because it is hard to leave or enter the industry).

   (a) Draw a supply and demand diagram with linear curves (be careful about the elasticities). Label the equilibrium price and quantity.

   (b) Some firms are lobbying for a price floor p_f above the market equilibrium price. Show the resulting quantity q_f and show the effect on consumer and producer surplus and deadweight loss.

   (c) Do you recommend that your firm lobby for this policy? Remember that you are only considering the costs and benefits for your one firm, and these may differ in the short and long run. The answer is ambiguous, so state your reasoning.

2. Suppose that the Maine potato farmers are lobbying the state legislature for special state tax breaks. The public interest argument is to preserve the potato farming way of life.

Use the Wilson Matrix to analyze what kind of political situation this creates. Remember to be specific about what are the benefits and what are the costs. It works best to assume the public interest justification, at least for the sake of argument, and make that the benefit. Then the costs are whatever would pay for the regulation.