Wilf Csaplar Jr.   Economics 301   Homework #4   **Due Wednesday 9/21 by 9:00 AM**

Place your name on the back of this sheet of paper and nowhere else. Staple your answers face up on the front of this sheet of paper. Failure to follow these directions will cost you 10 points. Your assignment will be typed, except graphs can be drawn by hand and mathematical equations can be done by hand. Failure to type it will cost you 10 points. If you use double-sided printing or print on the back of scrap paper, I will give you one additional point.

1) (15 points) The article below talks about how the Spanish CPI overestimates the inflation rate. I do not care if you understand how it overestimates inflation. What I want to know is: "How that overestimation causes problems for the government's budget and how does it impact individuals?" Which type of price index (Laspeyres or Paasche) also has the problem of overestimating inflation? Briefly explain how it overestimates inflation.
https://www.reuters.com/markets/europe/inflation-quirk-that-is-costing-spain-billions-2022-05-1
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2) (35 points) Draw an indifference curve/budget constraint for steak and potatoes. Illustrate the effects of an increase in the price of steak. Explain why the curve(s) moved as drawn. Now put in a new line to represent the budget constraint for calculating the Paasche Price Index. Explain how you got that line, how you would find the new price index, and how it shows that it underestimates the costs of inflation.

3) (50 points) Draw an indifference curve/budget constraint diagram for air conditioners and heaters. Have the initial situation be a price of an air conditioner is $10/AC, the price of a heater is $5/heater, and your income is $60. Illustrate the effects of an increase in the price of a heater going to $6/heater, and then $10/heater. Explain why the graph changed as drawn. As drawn, are they substitutes or complements? Explain how you reached that conclusion. Draw the price-consumption path. State how you found it. Use that data to find three points on the demand curve. State how you found the points and plot them.