University of Toronto
Department of Economics

ECO101: Principles of Microeconomics
Profs. Farhoodi/Freitas/Gazzale

**Assessment 3 (7 AM): Solutions**

What follows is generally a complete explanation as opposed to what would be expected from students in order to earn full marks. Where appropriate we have underlined key concept that are necessary, but not necessarily sufficient, to earn full marks.

**Pro tip:** The modal student wrote too much for question 1. Way too much.

1. **[15 marks]** Assume a standard perfectly competitive market. Consider the introduction $1 per-unit tax, payable by the buyer, where the item is still transacted after the tax is introduced.
    a. **[5 marks]** It seems obvious that the tax decreases consumer surplus. Explain why the obvious is, in fact, true in a standard perfectly competitive market.

    A tax will cause the effective prices to the consumer to rise (Pb, the price the buyers pay), regardless of statutory incidence (i.e., who writes the check). For every unit bought the surplus is smaller than before (as decrease in market price is less than $1). As the effective consumer price is higher, fewer units will be bought as well. Both these two effects will cause CS to decrease.