University of Toronto
Department of Economics

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

Assessment 3 (9 PM): 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. **[17 marks]** Assume a competitive market for gasoline. Due to COVID, demand for gasoline has fallen as have prices. As a result, assume the Canadian government is considering imposing a binding price floor. The government cares about producer well-being, but also cares about the sum of producer and consumer surplus.
    a. **[10 marks]** Explain how the price floor will impact both producer surplus as well as the sum of consumer and producer surplus. Make sure to discuss what factors will determine the size of any surplus change, and clearly state any assumptions you are making.

    The sum of producer and consumer surpluses must fall: it is maximized at the competitive equilibrium (all units where MWTP≥MC). As the floor reduces transactions, we lose transactions that would have created surplus (i.e., MWTP-