

Applied Price Theory

Economics 34201

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Problem Set #1

(Due 11/10/2009)

In recent years the price of oil has risen substantially, from less than \$30 to over \$100 per barrel and then declined. Use what you know about production theory and economics to set up an economic framework for analyzing the effect of these price changes on the U.S. economy. Gather some data on the history of oil prices and oil consumption (as well as any other data you think you will need in order to complete your analysis) as well as estimates of the effects of past oil shocks. Use these data to address several issues including:

- 1) How much will the U.S. lose due to the rise in oil prices?
- 2) How much will the rise in oil prices reduce real wages for U.S. workers?
- 3) How will the increase in oil prices affect real GDP?
- 4) How will these effects differ in the short-term and in the long term? How would the model you use to do the analysis differ for these different horizons?
- 5) What data could you look at to see whether the market thinks the oil price changes are temporary or permanent?
- 6) Would the effect of this oil price shock be larger or smaller than the effect of the shocks in the 1970s and 1980s? Why? How would you quantify this difference?