Kerry has a budget of $M to spend on two goods: X and Y. The price of good X is $6 per unit and that of good Y is $5 per unit. Kerry’s budget line is presented below. At the most affordable point, Kerry consumes 8 units of good X and **A** units of good Y.



1. Find the values of **M**, **A** and **B**.
2. At the most affordable point, what is Kerry’s marginal rate of substitution (MRS) of good X for good Y? Explain briefly how you obtain the result.
3. Copy the budget line and indifference curve I2 on your answer sheet. Suppose the prices of good X decrease by $2 per unit. Sketch (as accurately as you can) the new budget line in the diagram and indicate the new equilibrium point by drawing an additional indifference curve.
4. In part (c), is it possible that when the price of good X goes down, its consumption also goes down?

**Food Stamps**

1. A country recently passed a food stamp legislation. Qualified households are given food stamps, which can be used to purchase foods, but they cannot legally re-sell the food stamps. Suppose a household receives a grant of $600 of food stamps per month. How will this household’s budget line be affected? (Hint: Consider two goods: food and other goods.)
2. Show that if the food stamps could be legally re-sold, the household would be better off. Give one reason why food stamps should *not* be re-sold.