

**AUSTRALIAN GRADUATE SCHOOL of MANAGEMENT**

**Strategic and Economic Thinking**

Term 1, 2000

*Case study 2*

***Due: in tutorials on Thursday, 9<sup>th</sup> March, 2000***

Read the following case and answer the questions after it. This is a group assignment. Each member of the group will be given the same mark. For those of you who feel more comfortable with economics, use the assignment to assist those who might feel less competent in the economic way of thinking.

## Questions

- 1) Is the price elasticity of demand for cigarettes elastic or inelastic? Explain.
- 2) Will an increase in the tax rate on cigarettes lead to an increase or decrease in government revenue?
- 3) Illustrate an increase in the tax rate on a diagram. Show the incidence of the tax (that is, who bears the burden of the tax, the consumers or producers) on the diagram. How does the elasticity affect the incidence of the tax?
- 4) What assumptions did you make about the supply of cigarettes? Do your assumptions affect your answer to question 3?
- 5) What effect will long-run influences such as a change in the composition of the population who smokes or the impact of the government's anti-smoking campaigns have on the demand for cigarettes? Use a diagram to illustrate the effects of these changes on revenue raised at current tax rates.
- 6) For many products, demand is relatively inelastic in the short run and relatively elastic in the long run. Explain why this is true and whether or not this holds for cigarettes. Is your conclusion consistent with your assessment of the long-run shift in the demand curve for cigarettes? Use a diagram to show the impact of this change on the effects of further tax rate increases.