

During August of 2006, the inhabitants of Little Town consumed 1.2 million gallons of retail water while being charged \$1.01 for each 1000 gallons. In 2007 the price was raised to \$1.12/kGal, and August consumption was 1.15 million gallons.

The Town Council is considering raising rates for 2008 – to \$1.34/kGal.

- a. Compute the constant elasticity demand function that is precisely consistent with 2006 and 2007 data. What demand elasticity is indicated?
- b. Estimate the quantity of water that will be demanded in August 2008 if the proposed rates are approved. What assumptions does your estimation procedure involve?