

\$160, the consumer can buy the same market basket as before the inflation. (Point M). But the consumer can increase utility by substituting away from the good that increased most in price by moving to the left along the budget line through point M.

Part IV (30 points) Answer only question 1 OR question 2.

- George's demand function is not but Harry's is homogeneous in income and prices. For Harry, $q_m(\rho p_m, \rho p_p, \rho M) = 10(\rho p_m)^{-0.5}(\rho p_p)^{0.3}(\rho M)^{0.2} = \rho^0 10 p_m^{-0.5} p_p^{0.3} M^{0.2} = q_m(p_m, p_p, M)$. Therefore, only Harry could be a utility maximizer.
- The marginal utility of L is $\partial U/\partial L = 1.5L^{-1/2}$; the marginal utility of income is $\partial U/\partial M = 4$. Clearly, the $MRS = 4/(1.5L^{-1/2})$ does not depend only on the ratio L/M , so the function is not homothetic. It is quasi linear because the marginal utility of one good, M, is constant! Because of the quasi-linear nature of the utility function, leisure does not depend on M. Tom will spend all his inheritance on other goods and work just as hard as before.

About the Honors Option: The easy trick is to apply an artfully chosen monotonic transformation, $T(U) = \exp(U-10) = e^{U-10}$. We have $U^* = T(U) = \exp(U-10) = X^{1/4}Y^{3/4}$, which is the standard Cobb-Douglas form used in the book and in class.

The average grade on the quiz was 85. Scores usually rise during the semester. Grades on the writing assignment are usually higher than the quiz grades.

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How to do better:

- Do a preliminary reading of the textbook assignments before class. Reread after class.
- Attend the TA Sessions and/or make use of my office hours. They are free.
- Study with a friend.
- Don't try to read textbook stuff on the web. Print it out.
- Start on the problem set several days before it is due.
- If you had difficulties with a problem set, check yours over when you get it back with the star answer on reserve.
- Don't be afraid to ask questions in class and at the review sessions.