GS/ECON 5010 section "B" APPLIED MICROECONOMICS

Midterm Exam October 26 2011 2:30 – 3:30 pm

Do all 3 questions. All count equally.

1. What are the Marshallian (uncompensated) demand functions for a consumer whose preferences can be represented by the utility function

$$u(x_1, x_2) = 100 - \frac{1}{x_1} - \frac{4}{x_2} \qquad ?$$

2. How much would a risk–averse expected utility maximizer be willing to pay for an insurance policy which offers complete coverage against a loss of L if her initial wealth were W, the probability of the loss were π, and her utility–of–wealth function were

$$U(W) = \ln W \qquad ?$$

3. Explain why perfect competition is inconsistent with increasing returns to scale.