

Midterm Exam October 28 2015 2:30 – 3:30 pm

Do all 3 questions. All count equally.

1. State and prove the Slutsky equation, relating the derivatives of the Marshallian and Hicksian demand functions.

2. If a person has a constant coefficient of relative risk aversion equal to 2, and initial wealth $2X$, what would be the highest amount that she would be willing to pay to insure completely against an accident causing a loss of X if she perceived the probability of that loss as equalling some π (with $0 < \pi < 1$)?

3. What is the cost function for a firm with production function

$$f(x_1, x_2) = x_1 + \log(x_2 + 1) \quad ?$$