

Practice Problems #2

1. Suppose your non-labor income was \$25, your wage was \$5 an hour, and the total time available in the day was 20 hours: (1) draw your budget constraint for the labor-leisure model; (2) solve for optimal amount of consumption and leisure given that $MU_L/MU_C=C/L$ and indicate solution on graph; and (3) indicate the utility maximizing hours of work. (16 points)

2. Income and Substitution Effects. Draw a labor-leisure graph for a decrease in the wage that indicates that:

A. leisure is a normal good, but implies that the labor supply has a negative slope.

B. leisure is a normal good, but implies that the labor supply has a positive slope.

C. leisure is inferior (i.e., the labor supply has a positive slope).

3. Reservation Wage: Use a diagram and the definition of the reservation wage to help you explain how and why _____ can induce a worker to move from an interior to a corner solution.

A. the birth of a child

B. an increase in non-labor income when leisure is normal.