

Practice Problems #3

Most real estate transactions pay realtors a commission of 6 percent of the sale of which 2 percent is paid to their real estate office. This translates to \$25 an hour for the average relator. Recently, however, a firm called TREX has adopted a system whereby the relator pays the firm \$50 a day upfront, but then keeps the full 6 percent commission or \$37.50 an hour for the average relator.

A. Draw two budget constraints on the same graph for the average relator working for TREX and the "standard" real estate firm if there are 20 hours in the day to work or leisure and nonlabor income is equal to zero.

B. There has been much complaining from "standard" real estate firms that TREX has hired all of the "good" realtors. Use your graph in (A) to show that realtors who work more than four hours a day for a standard firm would prefer working for TREX.

C. Use the concept of income and substitution effects to explain why realtors work harder for TREX than for standard firms.

Note: Use the logic developed in the Welfare Program section of the course to help you solve this problem. This problem involves the same concepts: Specifically, a change in non-labor income and a change in the slope of the budget constraint. Feel free to come by and talk to me if you are having difficulty with this problem.