

Intermediate Micro HW 2

June 6, 2016

DUE DATE: June 13, 2016 at start of class

1 Leontief & Substitution

An individual has Leontief preferences over goods x_1 and x_2 . He starts with income y and the two goods have respective prices p_1 and p_2 .

The price of good x_2 increases to p_2' . Decompose this individual's change in demand into income and substitution effects.

2 CES Demand

Another commonly used class of utility functions is CES utility, which stands for **constant elasticity of substitution**. In general they take the form:

$$u(x_1, x_2) = (\theta x_1^\rho + (1 - \theta)x_2^\rho)^{\frac{1}{\rho}}$$

3 Textbook Exercises

Varian Exercises 4.3, 4.4, and 5.5