(1) MAX $V(c,q)$ [CONSUMER PROBLEM]

S.T. $y = c + pq + tx$

F.O.C $pV_c = V_q$ (1)

FREE-MOBILITY $V(y - pq - tx, q) = \bar{u}$ (2)

(2) $\Rightarrow$ $V_c[-pq_t - p_t q - x] + V_q q_t = 0$ (3)

(2) $\to$ (3) $\Rightarrow$ $p_t = -x/q < 0$ FOR $x > 0$. (4)

$\max_s \ l[ph(s) - r - iS]$ [HOUSING FIRM PROBLEM]

F.O.C $\Rightarrow$ $ph_s = i$ (5)

FREE-ENTRY $\Rightarrow$ $ph(s) - r - iS = 0$ (6)

(6) $\Rightarrow$ $p_t h + ph' \cdot S_t - r_t - iS_t = 0$

USING (5) $\Rightarrow$ $r_t = h \cdot p_t$

$\boxed{\therefore \text{ USING (4) WE HAVE } r_t = \frac{-xh}{q} < 0 \text{ FOR } x > 0}$

$D \equiv hq^{-1}$ SO WE HAVE:

$$D_t = \frac{-h(s)q_t + h' S_t q}{q^2} \quad (7)$$

$h, h', q, q^2 > 0$ BY ASSUMPTION. THAT JUST LEAVES q_t, S_t.

BUT $q_t > 0$ B/C $p_t < 0$ AND q_t IS A COMPENSATED DEMAND.

$\longrightarrow$

TOTAL DIFFERENTIATING (5), WE HAVE

$$p_t h' + p h'' \cdot s_t = 0$$

$$\Rightarrow \quad s_t = \frac{-p_t h'}{p h''} = -\left[-\frac{x}{g} \frac{h'}{p h''} \right] < 0 \quad (8)$$

USING (8) IN (7), TOGETHER WITH $g_t > 0$, WE HAVE $D_t < 0$

THAT IS, AS $t \uparrow$, AT ANY x, WE HAVE LAND PRICES AND DENSITY $\downarrow$.

INTUITIVELY, AS $t \uparrow$ COMMUTE COSTS GO UP AT EACH x. AS COMMUTE COST $\uparrow$, LAND PRICES $\downarrow$ TO PRESERVE CONSTANT U. BUT THIS MEANS (1) THE CAPITAL LAND RATIO SHOULD FALL (2) HOUSING PER PERSON $\uparrow$. TOGETHER THIS MEANS $D \downarrow$.

ANOTHER WAY TO THINK ABOUT THIS IS, AS $t \uparrow$ WE ARE RESCALING THE x AXIS, AND EACH x "LOOKS LIKE" A LOCATION THAT WAS MORE REMOTE WITH SMALLER t.

(2) MAX $u(c)$

$w = c + R(x) + 2tx$

(a) LET $c^* = u^{-1}(\bar{u})$.

THEN WE HAVE $R(x) + 2tx = w - c^*$ ① $\forall x \in [-\bar{x}, \bar{x}]$

IN PARTICULAR, $\bar{R} + 2t\bar{x} = w - c^*$

$$\Rightarrow \quad \bar{x} = \frac{w - c^* - \bar{R}}{2t}$$

(b)(i) FROM ABOVE, WHEN w INCREASES TO w', WE HAVE

$$\bar{x} = \frac{w - c^* - \bar{R}}{2t}$$

AND $\bar{x}' = \bar{x} + \dfrac{w' - w}{2t}$

From ①

$$R(x) = \begin{cases} w - c^* - 2tx & x \in [-\bar{x}, \bar{x}] \\ \bar{R} & \text{ELSE} \end{cases}$$

$$R'(x) \begin{cases} w' - c^* - 2tx & x \in [-\bar{x}', \bar{x}'] \\ \bar{R} & \text{ELSE.} \end{cases}$$

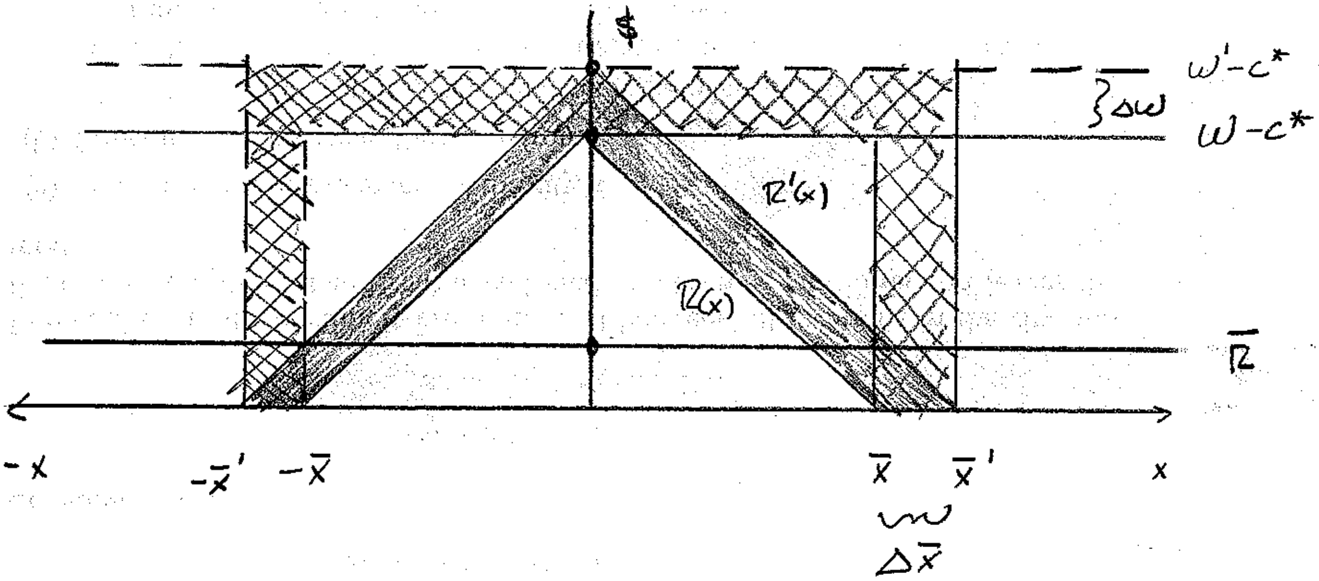
THUS

$$R'(x) - R(x) = \begin{cases} w' - w & x \in [-\bar{x}, \bar{x}] \\ w' - c^* - 2tx - \bar{R} & x \in \{[-\bar{x}', -\bar{x}] \cup [\bar{x}, \bar{x}']\} \\ 0 & \text{ELSE} \end{cases}$$

→

SO $$\int_{-\infty}^{\infty} R' - R \, dx = 2\left[(w'-w)\,\bar{x} - \tfrac{1}{2}\left(w - c^* - 2t\bar{x}' - \bar{R}\right)\left(\bar{x}' - \bar{x}\right)\right]$$

(11) IF NEW MIGRANTS WERE ALSO PAID w, THEN AGG. WAGE INCREASE IS $2\bar{x}(w'-w)$.



THE HATCHED AREA GIVES CHANGE IN AGGREGATE WAGE INCOME RESULTING FROM Δw.

THE SHADED AREA GIVES INCREASE IN AGGREGATE LAND RENT FROM Δw

THE INCREASE IN WAGES IS <u>LARGER</u> THAN THE INCREASE IN RENT BY ABOUT $2\Delta\bar{x}\, w'$.

HOWEVER, THE INCREASE IN WAGES <u>NET OF COMMUTING</u> IS COMPLETELY CAPITALIZED INTO RENT.