

ECO 735 Homework #1

Assigned January 12, 2012

Due January 17, 2012

1. Assume that a person's preferences over consumption and non-market time follow a Stone-Geary function such that $U(C, L) = \beta \ln(C - \gamma) + (1 - \beta) \ln(L - \mu)$. Using the standard budget and time constraints, derive the optimal labor supply and consumption functions. How does the labor supply function react to changes in wages and non-labor income?
2. Suppose that a person is subject to fixed costs of work. That is, if the person does not work, her income is N , and if the person does work, her income is $N - \phi + WH$, where ϕ is the fixed cost of work. Note that the cost is fixed in the sense that it does not vary with hours of work. Draw the budget constraint and graphically derive the labor supply function.