

Intermediate Microeconomic Theory (ECON 4200)
Study Guide for Exam # 2

Chapter 5: Household as Supplier

- 1.) Understand the consumption leisure model and be able to identify how much leisure and consumption and individual would choose. (be able to depict a budget constraint reflecting the tradeoff between leisure and consumption as well as the indifference curves between these activities).
- 2.) Know what the “cost” or “price” of leisure is (it is not free).
- 3.) Understand how individuals will respond to changes in their wage rate. (It depends upon the magnitude of their income and substitution effects, understand these concepts and be able to identify them graphically).
- 4.) Understand how the labor supply curve is derived from the consumption leisure model and understand what it means if it has a positive or negative slope.
- 5.) Understand how the labor supply curve can have both a positive and negative slope.
- 6.) Be able to show how an income support program could cause an individual that was working to stop working.
- 7.) Understand the concept of a Compensating Differential to explain why different jobs pay different wages. (Ex. Show graphically the tradeoff between job safety and wages).
- 8.) Understand the concept of producer surplus for labor. Understand how why an individual would not need to receive unemployment payments that were equal to their original salary to be as well off as they were before they lost their job.

Chapter 6: Choice under Uncertainty

- 1.) Understand how to develop a decision tree to reflect a choice problem where the outcomes are uncertain. (Like you did on the homework assignment)
- 2.) Be able to identify the value of information. (Be able to determine whether it is worth it or not to pay some amount of money to eliminate the uncertainty of a choice, like we did for a radon test in class.)

Chapter 7: The Firm and its Goal

- 1.) Understand the economic costs, revenues and profits. (Be able to work through a numerical example like we did in class and on the homework)
- 2.) Understand the difference between implicit and explicit costs and why an economist would include both.

- 3.) Understand and be able to apply the profit maximizing rule of producing up to where $MR = MC$ (Equimarginal principle) both graphically and using a table of numbers.
- 4.) Understand the reasons why some people criticize the assumption of profit maximization as a goal. (Make sure you understand the principle agent problem).

Chapter 8: Technology and Production

- 1.) Understand the concept of a production function and be able to explain what it means that they are a cardinal measure.
- 2.) Understand what an isoquant is and what it shows.
- 3.) Understand marginal productivity of an input and the different types of marginal returns (Increasing, diminishing, and constant) that this concept can display. Understand the law of diminishing marginal returns.
- 4.) Understand how to calculate the Marginal Rate of Technical Substitution (MRTS) and interpret what it means. Remember how the MRTS and Marginal Productivity (MP) of an input are related.
- 5.) Understand what the isoquants look like for perfect substitutes and no factor substitutes.
- 6.) Understand returns to scale (increasing, constant, and decreasing) and make sure you understand how this concept differs from marginal returns.

Chapter 9: Cost

- 1.) Understand what an Isocost depicts and how to graph it from a set of input prices. (make sure you can determine Isocost slopes)
- 2.) Understand how isocosts will change when the price of an input changes.
- 3.) Be able to combine isocosts with isoquants to determine the cost minimizing combination of inputs required to produce some level of output.
- 4.) Understand how the cost minimizing input combination will result in $MRTS = w/r$ which can be rewritten as $\frac{MP_L}{w} = \frac{MP_K}{r}$ and what this statement means.
- 5.) Be able to use comparative statics to identify how firms will respond to changes in their input prices, technological improvements, output quality, output levels.
- 6.) Understand what the expansion path shows and how it is derived.

* Good Luck *